Posted on: May 6, 2011

ADVISING THE INSOLVENT TENANT: ETHICAL ISSUES

May 6, 2011

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Prepared for the Continuing Legal Education BC conference "Commercial Leasing: Arbitration and Remedies"

I. INTRODUCTION

When a commercial tenant is in financial difficulty, there are usually several creditors seeking to recover debts owed to them by that tenant who has limited financial resources. It is important for a tenant to understand who to pay first and how best to prioritize its creditors, depending on the types of creditor's claims.

In difficult economic times, a tenant may need help from its landlord in order to survive. "Help" can come in a number of forms; sometimes through direct negotiated solutions and other times through equitable principles. For instance, a landlord may:

(a) agree to a reduction or abatement of rent;

(b) permit a tenant to surrender its lease before the expiry of the lease term;

(c) consent to a tenant's request to assign its lease, sublet all or a portion of its premises, or sell its business to a new operator;

(d) promise not to enforce the strict terms of a lease for a period of time (promissory estoppel); or

(e) waive its right to enforce a term under the lease.

Some of the tools available to an insolvent tenant include corporate reorganizations and insolvency protection under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*"), and under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c.C-36 (the "*CCAA*").

It is also important for a tenant to understand and avoid a fraudulent preference or conveyance of property. The issue can arise if a creditor is trying to improve its position with a tenant on the eve of insolvency, or

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when a tenant, on the verge of going out of business, starts to transfer assets out of its hands to the prejudice of other creditors.

When all hope seems lost, a tenant may be tempted to simply abandon the premises and remove its inventory but that can give rise to further problems with your landlord.

Your job as the tenant's lawyer is to navigate through the options without stepping on any ethical land mines along the way. In the process, you need to be mindful of your duties as a lawyer, paying particular attention to the Professional Conduct Handbook:

"Chapter 1: Canons of Legal Ethics:

1. To The State

(1) A lawyer owes a duty to the state, to maintain its integrity and its law. A lawyer should not aid, counsel, or assist any person to act in any way contrary to the law.

....

3. To The Client

(5) A lawyer should endeavour by all fair and honourable means to obtain for a client the benefit of any and every remedy and defence which is authorized by law. The lawyer must, however, steadfastly bear in mind that this great trust is to be performed within and not without the bounds of the law. The office of lawyer does not permit, much less demand, for any client, violation of law or any manner of fraud or chicanery. No client has a right to demand that the lawyer be illiberal or do anything repugnant to the lawyer's own sense of honour and propriety.

Chapter 4: Avoiding Questionable Conduct:

6. Dishonesty, Crime or Fraud of Client

A lawyer must not engage in any activity that the lawyer knows or ought to know assists in or encourages any dishonesty, crime or fraud, including a fraudulent conveyance, preference or settlement.

Chapter 8: The Lawyer as Advocate

1. Prohibited Conduct

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(b) knowingly assist the client to do anything or acquiesce in the client doing anything dishonest or dishonourable."

II. PRIORITIZE YOUR CREDITORS AND THEIR CLAIMS

A. Government Liens and Deemed Trusts

Federal, provincial and municipal governments often have a statutory lien or a deemed trust which gives the Crown a "super priority" over most other creditors.

The Federal Crown has special tools for recovery of tax through deemed trusts and attachment powers in the *Income Tax Act*, R.S.C. 1985, c. 1, as amended (the "*ITA*") and the *Excise Tax Act*, R.S.C. 1985, c. E-15, as amended (the "*ETA*").

Every person who deducts or withholds an amount under the *ITA*, the Canada Pension Plan, R.S.C. 1985, c. C-8 as amended (the "*CPP*"), and the *Employment Insurance Act*, R.S.C. 1996, c. 23 as amended (the "*EIA*"), is deemed to hold the amount separate and apart from their own property in trust for the Federal Crown. These deemed trust provisions under the *ITA*, *CPP* and *EIA*, apply notwithstanding the *BIA*, any other legislation, or any other law. The deemed trust applies from the time the amount was deducted or withheld, whether or not it has in fact been kept separate and apart and whether or not the property is subject to a security interest. The deemed trust amount must be paid to the Receiver General in priority to all other security interests.

The *ETA* deals with the federal Goods and Services Tax and the Harmonized Sales Tax. The deemed trust under the *ETA* is specifically defeated by a bankruptcy or a proposal under the *BIA*: *ETA* sections 222(1.1) and 222(3). The *ITA* deemed trust provisions, however, do not defer to any other legislation and trump all other competing statutory provisions.

The BC Crown also enjoys the benefit of statutory liens which have priority over pre-existing security. While the list of BC statutory liens is too long to review in detail, the most significant examples of these "super priority" liens are:

1. *Corporation Capital Tax Act* lien to secure tax imposed or assessed under that Act;
2. *Employment Standards Act* lien for unpaid wages; and
3. *Workers Compensation Act* lien for amounts due by an employer to the Workers Compensation Board.

Municipal and local governments also have statutory lien rights for real property taxes which are deemed to

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be a charge on the land and improvements with priority over any claim or encumbrance of any other person except the Crown.

Often these government liens and deemed trusts involve claims that also expose a director of the corporate debtor to personal liability as well.

B. Secured Creditors Holding Personal Guaranties or Indemnities

A secured creditor will often be the tenant's most important creditor, holding collateral security, personal guarantees and indemnities, in addition to its primary security. From the tenant's perspective, after the Crown's claims, the tenant should look after the creditor who has the most security because that creditor will have access to more sources for payment of monies owed than other, unsecured creditors, like trade suppliers. Unless that secured creditor holds a purchase money security interest, however, it will lose priority to a landlord exercising rent distress: *Rent Distress Act*, R.S.B.C. 1996, c. 403 (the "*RDA*"), s. 3(4).

C. Landlords With Rights of Rent Distress

The common law right of rent distress allows a landlord to hold goods of a tenant, which are found on the leased premises, as a form of security for payment of rent arrears. A lien arises by operation of law, in favour of a landlord, once a landlord takes possession of the tenant's goods. The right is created at common law by the relationship of landlord and tenant. It is not a right given by statute although there are certain restrictions and limitations placed upon it by statute.

The right arises upon the non-payment of rent. At common law, a landlord has the right to seize and hold the goods of a tenant until the rent is paid, but no power to sell the goods. The right of sale only arises by statute under the *RDA*.

A landlord's rent distress has priority over a security interest in the goods of the tenant other than a purchase money security interest in goods that is perfected as of the date of distress: *RDA* s. 3(4). Bankruptcy effectively "flips" the priorities of secured creditors and landlords. The priority which a landlord's rent distress enjoys over secured creditors will be reversed if the tenant goes bankrupt: *Bank of Montreal v. Scott Road Enterprises Ltd.* (1989), 36 B.C.L.R. (2d) 118 (C.A.).

If the tenant goes bankrupt before the rent distress is complete, then the landlord must stop the rent distress and release the goods to the trustee in bankruptcy: *BIA* s. 73(4).

D. Contractual Liabilities to Unsecured Creditors

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Retail tenants can't operate without a steady supply of inventory. If a tenant is in financial difficulty, but is still trying to operate its business, then the tenant is going to have to find some way to ensure it has an adequate supply of inventory.

With small retail tenants, suppliers can control their exposure by insisting on payment before delivery of inventory. If, however, a supplier delivers goods to a tenant, on credit, without security, then that supplier is at risk of not getting paid. Unsecured creditors are typically the lowest priority for an insolvent tenant debtor.

Once a tenant files for bankruptcy, or if a receiver is appointed over the tenant's business, an unpaid supplier has a limited window and opportunity for recourse under the *BIA*. Section 81.1 of the *BIA* provides a 30 day remedy to a supplier of goods who has not received payment for those goods. Where a supplier of goods has sold and delivered goods to a purchaser for use in that purchaser's business, and the purchaser hasn't paid for the goods, then the supplier can repossess the goods and the purchaser, (or a bankruptcy trustee or a receiver of the purchaser) must release the goods to the unpaid supplier provided that certain conditions are met. The three basic conditions which must be satisfied are:

1. the supplier must present a written demand to the purchaser in the prescribed form within 30 days of the date of delivery of the goods to the purchaser,
2. the purchaser must be bankrupt or a receiver must have been appointed in respect of the purchaser's business, and
3. the goods must still be in the possession of the purchaser (or its trustee or receiver), the goods must be identifiable, the goods must be in the same state and condition as when they were first delivered and the goods must not have been re-sold to an arm's length purchaser.

Notwithstanding any other federal or provincial statute or law, s. 81.1(6) of the *BIA* states that the rights of unpaid suppliers rank above every other claim against the purchaser, other than the right of a bona fide purchaser of the goods for value, without notice of the supplier's demand to repossess the goods.

III. SEEK A RENT REDUCTION OR ABATEMENT AGREEMENT

Rent reduction and abatement agreements are usually only considered by landlords of shopping centres where the appearance of a fully occupied and vibrant retail centre is important, the traffic generated by one tenant is of benefit to other tenants in the centre and the number of customers attracted to the centre has a direct impact on the amount of percentage rent the landlord may collect from all tenants. Rent reduction and abatement agreements provide a landlord with the ability to recover its expenses for property taxes and operating costs for the centre even though the landlord may have to accept a lower return on its

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investment in the form of reduced base rent or minimum rent.

If a landlord is prepared to consider a rent reduction and abatement agreement, then it should always be reduced to writing. While the specific terms and conditions will vary from one agreement to the next, some of the points a landlord and tenant should consider, in negotiating a rent reduction and abatement agreement, include the following:

(a) For what period of time will the agreement remain in effect? A clear start date should be indicated. The end date should be the earlier of a fixed date, the date the lease expires or the date the landlord chooses to exercise an option to terminate. In determining a specific time period during which the agreement will remain in effect, the landlord should keep in mind that it may not resile from the agreement unless the agreement was entered into as a result of fraudulent or negligent misrepresentation. Further, if there is not a specific time period during which the agreement will remain in effect, then the landlord may only revert to the original rent amount payable after delivery of reasonable notice to the tenant of its intention to do so: Olson, R., *A Commercial Tenancy* Handbook, (Toronto: Thomson Canada Limited, 2004) ["*Olson*"} at p. 7-25; *International Knitwear Architects Inc. v. Kabob Investments Ltd.* (1995), 49 R.P.R. (2d) 268 (B.C.C.A.) at para. 29.

(b) Is rent going to be abated or simply deferred? Some landlords will only agree to defer rent and not abate rent. In that manner the deferred rent can be claimed if the tenant defaults or if another creditor takes action against the tenant.

(c) Will the abatement or deferment only apply to basic or minimum rent? A landlord should ensure that there is no reduction or abatement in additional rent (i.e. property taxes and operating costs) which is needed to cover the out-of-pocket expenses the landlord incurs to operate the property.

(d) Will all the landlord's default remedies under the Lease be preserved? If the tenant fails to pay the reduced minimum rent, or any of the additional rent, then the landlord should be entitled to exercise any of its rights and remedies at law, under the lease and under the specific rent reduction and abatement agreement.

(e) Will the landlord require an express right to terminate the agreement? If the tenant fails to pay the reduced rent or discloses its rent reduction and abatement agreement to any other tenant of the centre, or if a better tenant comes along, then the landlord may insist upon the right to terminate the rent reduction and abatement agreement and the lease. The agreement should also contain a provision that it be automatically terminated in the event of an assignment, sublease, sale of the tenant's business or a change in control of the tenant.

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(f) Will the landlord want a right to recapture abated or deferred rent? Some landlords may insist upon a right to recapture abated or deferred rent in certain circumstances (e.g. if the tenant breaches the confidentiality and non-disclosure provision or if another creditor takes steps to recover amounts due by the tenant).

(g) Is the agreement transferable? The agreement should make clear that the concessions granted are personal to the tenant, may not be transferred to the tenant's successors or assigns, and end in the event of a change of ownership or control of the tenant.

(h) Is the tenant currently in default? As a precondition to the agreement, the tenant should be required to pay any rent which is currently in arrears, and to cure all other defaults.

(i) Does the landlord need the approval of its lender? If the landlord obtained financing on the strength of the rent income in the lease, then the landlord may need the consent of its lender to reduce the rent.

(j) Are there any other modifications to the lease? The parties should acknowledge that, in all other respects, the terms and conditions of the lease continue in full force and effect.

IV. TRY TO NEGOTIATE A SURRENDER OF LEASE

A surrender by a tenant of its lease agreement leads to a destruction of the landlord-tenant relationship, upon the landlord's acceptance. A surrender of lease requires a clear act by both the landlord and the tenant: *Olson* at p. 6-17. If a landlord is found to have accepted a surrender of lease, the landlord may only be entitled to claim any arrears of rent up to the date of the acceptance of the surrender: *Olson* at p. 6-17.

Some examples of the types of acts by a landlord which may indicate acceptance of a surrender of lease by a tenant include advising the tenant the surrender has been accepted: *Daulat Investments Inc. v. Ceci's Home for Children* (1991), 85 D.L.R. (4th) 248 (Ont. Gen. Div.), taking possession of the premises: *Levesque v. J. Clark & Son Ltd.* (1972), 7 N.B.R. (2d) 478 (N.B.Q.B.), or changing the locks: *Commercial Credit Corp. v. Harry D. Shield Ltd.* (1980), 112 D.L.R. (3d) 153 (Ont. H.C.).

In negotiating the terms of the surrender, the landlord and tenant should consider the following:

(a) What is the effective date of the surrender? If the effective date defined in the agreement is a date after the execution of the surrender agreement, then the parties should ensure that there is consideration expressed, otherwise it has been suggested that a surrender is effective at once and cannot take effect on a future date: The Continuing Legal Education Society of British Columbia, *Commercial Leasing Annotated*

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Precedents, Updated February 2009 ["*Commercial Leasing*"].

(b) What amount of rent remains payable up to the effective date of the surrender? The parties may wish for the surrender agreement to be subject to one or more conditions precedent or subsequent, such as payment of rent in arrears or of a surrender payment by the tenant.

(c) By what date and in what condition is the tenant required to deliver vacant possession of the premises? The parties should determine from the lease whether the tenant has the right to remove its fixtures in addition to its furniture, equipment, etc.

Another consideration in determining whether to offer or accept a surrender of a lease is whether there exist any subleases under a head lease. A landlord should be aware of s. 38 (1) of the *Property Law Act*, RSBC 1996, c 377 (the "*PLA*") which provides the following:

38(1) If a reversion expectant on a lease is surrendered or merged, the interest which as against the lessee confers the next vested right to the land is deemed the reversion for the purposes of preserving the same incidents and obligations as would have affected the original reversion had it not been surrendered or merged.

The effect of s.38 (1) of the *PLA* is that if the landlord accepts a surrender of the lease, any sublease under that lease is promoted to a head lease. If the landlord does not wish for the subtenancy to survive the surrender of the head lease, then the subtenant will be required to consent to a surrender of its sublease as well.

V. REVIEW YOUR ASSIGNMENT AND SUBLETTING OPTIONS

An assignment of a tenant's interest under a lease involves a transfer of the tenant's rights, benefits and obligations from the original tenant as the assignor to the new tenant as the assignee. The effect of an assignment, therefore, is to substitute the assignee in the place of the assignor as the tenant under the original lease. A sublease is a demise of an interest in the leased premises by the tenant to a third party, a sub-tenant, but it does not place the sub-tenant in the place of the tenant under the original lease and therefore, there is no privity of contract or estate between that sub-tenant and the original landlord. A tenant should ensure that, if it wishes to retain its position as tenant under the original lease and only grant a sublease to the sub-tenant, the term of the sublease be for the term of the original lease, minus at least one day, otherwise the transfer becomes an assignment of the lease rather than a sublease: *Olson* at p. 3-42.

Unless there is a positive covenant on the tenant's part to refrain from subletting the premises or assigning

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the lease, the tenant may do so without the landlord's consent: *Leith Properties v. Byrne*, [1983] 1 Q.B. 433 (C.A.). Any demise of an interest in land carries with it the right to dispose of the interest, subject to the nature of the grant: *Williams & Rhodes, Canadian Law of Landlord and Tenant, 6th ed.* (Vancouver: Carswell, 1988).

In some cases, the lease may provide an option for the landlord to terminate the lease upon a request by the tenant to assign or sublet the premises, so it is important that the tenant review the assignment, sublease or change or control provisions under the lease prior to taking any actions.

The exact wording of the covenant relating to assignment or a sublease will be examined closely, and will be construed strictly against the landlord to ensure that the landlord's power to restrain the tenant's commercial activity does not exceed the express provision of the covenant: *Groves v. Portal,* [1902] 1 Ch. 727. For example, in *Zurich Canadian Holdings Limited v. Questar Exploration Inc.* (1999), 171 D.L.R. (4th) 457 (Alta. C.A.) an amalgamation of the tenant with another company was held not to have created an assignment requiring the landlord's consent.

Where an unauthorized sublease is alleged, it is often possible to characterize the agreement in question as a mere licence. For example, a management contract entered into by a tenant and a third party, governing the business carried on in the leased premises, was held not to constitute a sublease in *389079 B.C. Ltd. v. Coast Hotels Ltd.* (1998), 63 B.C.L.R. (3d) 359 (S.C.). In order for there to be a sublease as opposed to a mere licence, the contract must create an interest or an estate in land, there must be a right to exclusive possession (though exclusive possession is not necessarily decisive), and the intention of the parties and the substance of the contract must clearly indicate that an interest in the premises has been granted: *Lippman v. Yick*, [1953] 3 D.L.R. 527 (Ont. H.C.), cited in *389079 B.C. Ltd. v. Coast Hotels* (supra).

A. When May a Landlord Arbitrarily Refuse Consent and When Must a Landlord Act Reasonably?

Typically, commercial leases contain a covenant by the tenant not to sublet or assign without the prior written consent of the landlord. Such a covenant may be qualified by words stipulating that the landlord's consent can't be unreasonably withheld. It is not uncommon, however, to see words permitting the landlord to withhold consent, in its absolute discretion.

Some leases may contain a list of factors the landlord is entitled to consider in deciding whether to consent to an assignment or subletting. If the lease is silent on the factors for consent, a landlord will typically consider the following factors before granting its consent to the assignment or sublease:

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1. the financial strength and reputation of the proposed sub-tenant or assignee and its principals;
2. the operating name of the proposed sub-tenant or assignee; and
3. whether there will be a change of use of the leased premises by the proposed sub-tenant or assignee and the effect on other tenants in the building or centre.

It is open to the landlord to refuse consent arbitrarily or unreasonably if the covenant so provides. It is not clear whether a court will imply a term requiring the landlord to act reasonably where the provision is silent as to the circumstances in which the consent may be withheld. The principles of law governing implied terms are found in *Luxor (Eastborne) Ltd*. v. *Cooper,* [1941] A.C. 108, [1941] 1 All E.R. 33 (H.L.). Generally speaking, terms will only be implied when necessary to give such business efficacy to the agreement as the parties must have intended.

The question of whether a landlord's refusal to consent to an assignment or sublease is unreasonable is a question of fact to be determined on the evidence in each case, and case law on this point does not suggest any single factor that will determine what is reasonable. The test to be applied in determining whether consent has been unreasonably withheld is an objective test; would a reasonable person in the circumstances of the landlord have refused to consent to the assignment, considering the surrounding circumstances, the commercial realities of the marketplace and the economic impact of the assignment on the landlord: *Federal Business Development Bank v. Starr* (1986), 28 D.L.R. (4th) 582 (Ont. H.C.); cited by the British Columbia Court of Appeal in *Lehndorff Canadian Pension Properties Ltd. v. Davis Management Ltd.* (1989) 37 B.C.L.R. (2d) 306 (B.C.C.A.).

Prior to the evolution of this "reasonable person" standard, the common law relating to reasonableness of the landlord centred on a two-part test: first, whether the refusal is grounded upon the character of the proposed assignee or subtenant, and second, whether the nature of the use or occupation of the premises provided grounds for refusal: *Houlder Brothers & Co. v. Gibbs,* [1925] Ch. 575 (C.A.).

In *Viscount Tredegar v. Harwood,* [1929] A.C. 72, (H.L) acting reasonably was distinguished from acting "justly, fairly, or kindly". The court said reasonableness was to be construed with reference to the "consideration of the motives of convenience and interest" which affect the landlord "not those which affect somebody else".

The watershed case on this issue is *Premier Confectionery (London) Company Limited v. London Commercial Sales Rooms Limited,* [1933] Ch. 904 (Ch.). In that case, one tenant leased two separate tobacconist's shops. So long as one tenant ran both businesses, they did not compete with each other. The landlord refused to consent to the assignment of one of the leases by the tenant to a third party. While the

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landlord's refusal was not related to the character or financial circumstances of the assignee the court considered that the use to which the premises were to be put was undesirable in that it would create competition between two tenants of the property. The landlord was entitled to object to an assignment of one lease even though the proposed use was not forbidden by the terms of the lease.

In Canada, reluctance to adopt the restrictive two part test in *Houlder Brothers* (supra) was first voiced in the Ontario Court of Appeal decision in *Shields v. Dickler,* [1948] 1 D.L.R. 809 (Ont. C.A.).

More recent case law tends to follow the formulation of Lord Denning in *Bickel v. Duke of Westminster,* [1977] 1 Q.B. 517 (C.A.) where he concluded that the previous case law did not "lay down any propositions of law" and stated:

I do not think that the court can or should determine by strict rules the grounds by which the landlord may or may not reasonably refuse his consent. He is not limited by the contract to any particular grounds, nor should the courts limit him. Not even under the guise of construing the words. The landlord has to exercise his judgment in all sorts of circumstances. It is impossible for him, or the courts, to envisage them all … (The) circumstances are infinitely various it is impossible to formulate strict rules as to how a landlord could exercise his power of refusal. The utmost that courts can do is to give guidance to those who have to consider the problem…. The reasons given by the judges are to be treated as propositions of good sense – in relation to the particular case – rather than propositions of law applicable to all cases…. All that can be properly done is to indicate the chief considerations which help to arrive at a just conclusion.

This echoed his earlier comments in *Wilson N. v. Fynn,* [1948] 2 All E.R. 40 (K.B.):

I do not think it is necessary to lay down specific grounds whether conduct is reasonable or unreasonable. The circumstances of each case must be considered and in considering that point, I am not confined to the evidence with regard to the construction of the lease, but am entitled to have regard to the understanding that was contemplated by the parties when the lease was instituted.

The Ontario Court of Appeal in *Re Griff et al and Sommerset Management Services Ltd. (1978),* 84 D.L.R. (3d) 386, (Ont. C.A.) referred to Lord Denning's approach in *Duke of Westminster v. Bickle* (supra) as the "high-water mark in this area of the law".

That said, there remains the occasional case which links reasonableness between the landlord's grounds for refusal to specific provisions of the lease. For example, in *Canada Safeway Ltd. v. Triangle Acceptance Limited,* [1980] 3 W.W.R. 352 (Man. Co. Ct.), a landlord refused a sublease to a subtenant operating essentially the same business as the tenant on the grounds that there was a risk of a lower volume of

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shoppers which would have an impact on the other tenants of the landlord's premises. As there was nothing in the lease respecting a commitment to a volume of shoppers, Philp C.J. held that the landlord's refusal was unreasonable.

Reasonable refusals have included:

- where the landlord considered that the proposed sublease was calculated to depreciate the value of the property and would have detracted from the landlord's negotiations for a subsequent sale or mortgage of the property: *Re Town Investments Limited Underlease; McLaughlin v. Town Investments Limited,* [1954] 1 All E.R. 585 (C.D.).
- where the proposed use of the premises by the subtenant or assignee conflicts with the user clause in the lease: *Re Acklands Leasehold Properties Limited v. Stehild Investments Limited* (1981), 127 D.L.R. (3d) 646 (Ont. C.A.).
- where the assignee or subtenant's proposed use would conflict with the landlord's covenants to his other tenants: *Ayre's Limited v. Atlantic Shopping Centres Ltd.* (1989), 62 D.L.R. (4th) 12 (Nfld. C.A.).
- where the original tenant was to be an anchor tenant, and the proposed subtenant would not be considered an anchor tenant: *New Miracle Food Mart Inc. v. General Leasehold Ltd.*, [1993] O.J. No. 1293 (Ont. Gen. Div.).
- where the subtenants are in possession of the premises prior to consent being obtained: *Pink Panther Food Corp. v. N.D. McLellan Ltd.* (1988), 75 O.R. (2d) 651 (Ont. Dist. Ct.).

It is reasonable for a landlord to withhold consent until damages to the leased premises are repaired. *F.B.D.B. v. Starr* (supra). It is also reasonable for a landlord to withhold consent pending the receipt of financial information on the assignee or subtenant, as the landlord is entitled to make an informed judgment and to be satisfied that the assignment or sublease would not result in the premises being used or occupied in an undesirable way: *Moore v. New Progress Construction Ltd.* (1980), 9 Man. R. (2d) 434 (Man. Co. Ct.).

The landlord's lack of objection to the transfer does not amount to consent. The landlord must also be given reasonable time in which to consider the request.

Withholding of consent has been found to be unreasonable in the following circumstances:

- where the landlord is merely attempting to obtain a higher rent for the premises: *Dominion Stores Limited v. Bramalea Limited* (1985), 38 R.P.R. 12 (Ont. Dist. Ct.).
- where the landlord is attempting to obtain further commercial benefit and advantage from the lease such as further and better security: *St. Jane Plaza Limited v. Sunoco Inc.* (1992), 24 R.P.R. (2d) 161 (Ont. Gen. Div.).

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- where the tenant remains liable under the covenants, the assignee's financial condition will not provide grounds for reasonable refusal of consent *Lehndorff* (supra).
- where a landlord based his refusal on the risk of a lower volume of shoppers which would have an impact on the other tenants of the landlord's premises, and there was no commitment by the tenant in the lease to a volume of shoppers: *Canada Safeway Limited v. Triangle Acceptance Limited* (supra).

Where a landlord is aware of the assignment or sublease and continues to take rent payments from the assignee or subtenant, the landlord's action may amount to a waiver of the breach of covenant. This may extend to other actions of the landlord: *Mascan Corp. v. 27813 Ontario Ltd.* (1984), 3 O.A.C. 225 (C.A.).

Where the landlord gives a consent to a sublease, the subtenant is not bound by the tenant's covenant not to assign or sublease and a further sublease will not amount to a breach of the covenant not to sublease: *Royal Trust Co. v. Bell* (1909), 12 W.L.R. 546 (Alta. T.D.). For that reason, the landlord should insist that the subtenant also agree to be bound by the tenant's covenants in the head lease.

What is the burden of proof in showing unreasonableness? In *Coopers and Lybrand Ltd. v. William Schwartz Construction Co.* (1980), 116 D.L.R. (3d) 450 (Alta. Q.B.), the tenant who leased premises in a shopping centre went into receivership. When the landlord refused to consent to an assignment, the receiver challenged that decision. The court held that the onus was on the receiver to establish that the withholding of consent to the assignment was unreasonable. In that case the subtenant's business was not identical to that of the tenant and the landlord withheld his consent because the business of the subtenant was likely to affect the business of other tenants in the shopping centre. The landlord was entitled to consider the impact of the subtenancy on the other tenants and the court concluded that the receiver failed to establish that the landlord withheld his consent unreasonably.

B. What is a Tenant's Remedy When a Landlord Unreasonably Refuses Consent?

Historically, the covenant not to assign without the reasonable consent of the landlord has been construed as a tenant's covenant qualified by an obligation on the landlord to act reasonably. The traditional remedy granted was limited to declaratory relief; the covenant became inoperative, the tenant was released from the obligation not to assign if the consent was unreasonably withheld and was given an equitable right to the assignment or sublease. The tenant's course of action, therefore, was not to sue the landlord but rather, once the landlord unreasonably refused to consent, the tenant was free to simply go ahead with the assignment or sublease.

Historically, the unreasonable withholding of consent to assignment did not give the tenant a right of action

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or a right to damages but merely allowed the tenant to assign or sublease without consent: *Treloar v. Bigge* (1874) L.R. 9 Ex. 151. However, the modern conception of a lease is that it is as much a contract as a conveyance, and the full range of contract remedies is available: *Highway Properties Ltd. v. Kelly, Douglas and Co.*, [1971] S.C.R. 562 (S.C.C.), *Cudmore v. Petro Canada Inc.,* (1986) 2 B.C.L.R. (2d) 113 (B.C.S.C.). In *Lehndorff Canadian Pension Properties Ltd. v. Davis Management Ltd.* (supra), a landlord's unreasonable withholding of consent to a sublease was held to be a fundamental breach of the lease by the landlord giving rise to an election by the tenant to either treat the breach as a termination of the contract or affirm the contract and sue for damages: *Morrison-Knudsen v. British Columbia Hydro and Power Authority* (1978), 85 D.L.R. (3d) 186 (B.C.C.A.).

The tenant, if he believes that consent is being unreasonably withheld, may proceed with the assignment or sublease and seek a declaration from the court that consent is unreasonably withheld. However, this involves significant risk to the tenant as failure to obtain the declaration may be considered a forfeiture of the lease.

It does not appear that withholding consent unreasonably constitutes constructive eviction of the tenant: *Lehndorff Canadian Pension Properties Ltd. v. Davis Management Ltd.* (supra).

Assignment or sublease by the tenant made without requesting leave will be a breach of a covenant such that it causes a forfeiture of the lease, and the landlord may avail himself of the remedies available in that situation.

Where the tenant breaches the covenant not to assign or sublease, the measure of damages will be an amount that will put the landlord in the same position as if the tenant was still liable on the lease instead of the assignee or subtenant: *Williams v. Earle* (1868) L.R. 3 Q.B. (2d) 739. Where there is a flagrant breach of the covenant not to assign or sublet and there are damages to the premises by the assignee or subtenant, the tenant may be liable for those damages: *Lepla v. Rogers,* [1893] 1 Q.B. 31.

VI. CONSIDER EQUITABLE DEFENCES

A. Promissory Estoppel

The doctrine of promissory estoppel finds its roots in *Central London Property Trust Ltd. v. High Trees House Ltd.*, [1947] 1 K.B. 130, [1956] 1 All E.R. 256 (K.B.). In that case a landlord and tenant entered into a 99 year lease at a rent of £2,500 per year. The lease was entered in 1937 and by 1940, with the outbreak of war; the tenant was unable to pay the stipulated rent. The landlord agreed, in writing, to an arrangement by which the rent was reduced to £1,250 per year. No duration of the reduction of rent was specified and

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there was no consideration given to the landlord. Lord Denning, then of the Kings Bench Division, wrote a judgment which explains the doctrine which has become known as promissory estoppel. In cases where a promise is made which (a) was intended to be binding, (b) the party making it knew would be acted on and (c) the party to whom it was made did act on, the court will hold the promise to be binding on the party making it, even though it was made without any consideration being given.

In *International Knitwear Architects Inc. v. Kabob Investments Ltd.* (1995), 49 R.P.R. (2d) 268 (B.C.C.A.), a commercial tenant began to experience financial difficulties two years into a five-year lease term. The tenant couldn't afford to pay the rent and asked the landlord if it would agree to a rent reduction. The landlord "displaying a good natured wish to help his tenant through a difficult time" agreed to accept reduced rent. Even though the tenant did not give any fresh consideration for a rent reduction, the effect of the "arrangement" was to create a promissory estoppel which prevented the landlord from enforcing its right to recover the full rent stipulated by the lease. The Court of Appeal found that the estoppel continued until the landlord gave reasonable notice of its intention to revert back to the strict terms of the lease. Madam Justice Southin, writing the decision for the Court of Appeal, concluded that the landlord was entitled to give, and the tenant was obliged to accept, reasonable notice to revive the strict obligations of the lease: paragraph 29. In the circumstances of that case, the Court of Appeal concluded that a reasonable time to revive the full rent obligation was five weeks' notice.

B. Waiver

Like promissory estoppel, waiver is another remedy based in equity, upon which a tenant may rely as a defence to a landlord's claim. While promissory estoppel focuses on the actions and reactions of both the landlord and tenant, waiver arises unilaterally in that it focuses on one party's knowledge and intention in abandoning or relinquishing its legal right: *Chan v. Lorman Developments Ltd.*, [2007] 10 W.W.R. 227 (S.K.Q.B.). Where a landlord and tenant engage in a dispute, the action of either party may give rise to waiver if such action is said to affirm the contract despite knowledge that the other party has breached the contract. The effect of waiver is that it removes the right of the innocent party to terminate the lease by reason of default by the other party, although it may not necessarily waive the innocent party's right to seek damages arising from the breach of the lease. Waiver often arises where rent has been accepted or paid following a default by the other party that would have otherwise resulted in a right to terminate the lease: *Olson*.

In *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 S.C.R. 490, the Supreme Court of Canada set out the following test for waiver:

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[20] Waiver will be found only where the evidence demonstrates that the party waiving had (1) a full knowledge of its rights; and (2) an unequivocal and conscious intention to abandon them. The creation of such a stringent test is justified since no consideration moves from the party in whose favour a waiver operates. An overly broad interpretation of waiver would undermine the requirement of contractual consideration.

Often a lease may contain a non-waiver clause which stipulates that subsequent acceptance of rent by the landlord is not deemed to be a waiver of any prior breach by the tenant of any term of the lease, regardless of the landlord's knowledge of such prior breach at the time of acceptance of the rent. The courts have held, however, that acceptance of rent in the face of knowledge of a tenant's breach constitutes an unequivocal act which recognizes the continued existence of the lease and effectively overrides a non-waiver clause: *Delilah's Restaurant v. 8-788 Holdings Ltd.*, [1994] B.C.J. No.1340 (C.A.)*; North Gordon Industrial Park Inc. v. Rackster Hosting Inc.*, [2008] B.C.S.C. 267.

The *Delilah's Restaurant* case involved a dispute over whether a tenant had breached a lease agreement and if so, whether the landlord had waived its right to terminate the lease based on such breach by continuing to accept rent after learning that the tenant was in breach. The lease between the landlord and tenant contained a non-waiver clause set out as follows:

12 No condoning, excusing or overlooking by the Landlord or Tenant of any default, breach or non-observance by Tenant or Landlord at any time or time [*sic*] in respect of any covenant, proviso or condition herein contained shall operate as a waiver of any continuing or subsequent default, breach of [sic] non-observance, or so as to defeat or affect in any way [*sic*] the rights of Landlord or Tenant herein in respect of any such continuing or subsequent default or breach, and no waiver shall be inferred from or implied by anything done or omitted by Landlord or Tenant save only expressed waiver in writing. All rights and remedies of Landlord in this Lease contained shall be cumulative and not alternative.

In considering the issue of whether the landlord lost its right to terminate the lease by waiver, the Court of Appeal, by majority decision, held the following:

1. where there is a breach of a lease provision and a landlord subsequently with full knowledge of the breach, accepts rent from the tenant, such acceptance is sufficient to constitute a waiver at law;
2. the fact that there is a written non-waiver clause in the lease agreement is not fatal to a tenant's position;
3. the landlord's general course of conduct and full knowledge of the breach can be evidence indicating a clear intention on the part of the landlord not to rely on the breach and upon which the court can

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find a waiver by a landlord.

Since a clear intention on the part of the landlord to abandon its rights is required to find waiver, it is possible that a landlord may be able to avoid waiving a breach by accepting the payment of rent "under protest" which may provide evidence to a court that the landlord did not intend to waive the default: *Olson* at p. 6-8.

Should a party fail to enforce a provision in an agreement for the payment of certain costs, such party may, on reasonable notice, withdraw its waiver and reassert the burden of payment upon the other party: *Scotia Centre Ltd. v. EBJ Investments Ltd.*, [1994] 22 Alta. L.R. (3d) 80.

VII. CORPORATE REORGANIZATIONS AND INSOLVENCY PROTECTION

A. Bankruptcy and Insolvency Act

Some of the effects of a tenant's bankruptcy are discussed below including an automatic stay of legal proceedings commenced against the tenant and the inability of a landlord to exercise a contractual right to terminate a lease for non-payment of rent or to exercise common law rights of distraint.

Another very significant right available to a tenant upon filing Notice of Intention to make a proposal is the option of disclaiming a lease.

(1) Proposals to Creditors

Section 65.2 of the *BIA* gives tenants who have filed a Notice of Intention, the right to disclaim a commercial lease in certain circumstances. The purpose of this provision of the Act is to allow a tenant an opportunity to reorganize its corporate affairs.

The tenant who wants to disclaim or repudiate a commercial lease must act within a specific time period which starts when that tenant files its Notice of Intention and ends when the tenant files its proposal in bankruptcy. Typically that time period would be anywhere from 30 to 180 days.

A tenant who seeks to disclaim a lease must give 30 days notice to the landlord in the prescribed manner. A landlord receiving such a notice then has 15 days to apply to court for a declaration that the tenant is not entitled to disclaim the lease. If the landlord makes that application then the tenant will have to satisfy the court that it cannot make a viable proposal in bankruptcy unless it can disclaim the lease.

The compensation payable to a landlord when a tenant disclaims a lease under the *BIA* is limited:

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(a) a landlord has no claim for accelerated rent,

(b) a landlord's claim for rent arrears is not affected, and

(c) there are two basic options to compensate a landlord for losses resulting from a disclaimer of a lease. The first option is for the landlord to simply file a proof of claim for the actual losses resulting from a disclaimer. The second option is for the landlord to file a proof of claim seeking compensation based on a prescribed formula. The formula amount equals the lesser of:

(i) the total of the rent for one year from the date the disclaimer becomes effective plus 15% of the rent for the remainder of the lease term after that first year or,

(ii) three years rent.

If a tenant files a notice of intention to make a proposal under the *BIA*, a landlord will be prevented, by section 65.1, from terminating the lease by reason of rent arrears owing at the time of the filing of a notice of intention to make a proposal. The lease will continue to subsist while the tenant formulates and negotiates a proposal with its creditors. The purpose of section 65.1 is to maintain the status quo among creditors and preserve the tenant's debt or its assets during the reorganization process. Section 65.1 of the *BIA* does not, however, prohibit the termination of leases for non-payment of rent which falls due **after** the date the notice of intention is filed: *Canadian Petcetera Limited Partnership v. 2876 R. Holdings Ltd.*, 2010 B.C.C.A. 469. Section 65.1(4)(a) permits a landlord to require rent to be paid for the period after the notice of intention is filed.

(2) Impact of Bankruptcy on Legal Proceedings

Once a tenant files for bankruptcy, or is placed into bankruptcy by one of its creditors, there is an automatic stay of all legal proceedings against the tenant; the landlord is prohibited from commencing or continuing any legal action against the tenant, for the recovery of rent: *BIA*, s. 69.3. This stay of proceeding applies to the landlord's right to distrain, sue for breach of a lease, and to retake possession.

One of the primary objects of the *BIA* is to provide for the orderly and fair distribution of the property of a bankrupt among it creditors. The imposition of a stay of legal proceedings ensures that one unsecured creditor cannot gain an advantage over another. While the bankruptcy court has the power to lift this stay of proceedings, it is only done in exceptional circumstances. To obtain a court order granting leave to commence or continue with an action, a creditor must show that it is "materially prejudiced" by the stay or that it is "equitable" to lift the stay: *BIA*, s. 69.4.

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(3) Impact on Landlord's Right to Recover Rent

Section 136 of the *BIA* specifies those creditors whose claims are entitled to priority and the order of priority among those creditors. A landlord is one of the creditors who is given priority against other creditors of a bankrupt tenant.

A landlord ranks sixth in priority for arrears of rent which relate to the last three months immediately before the tenant's bankruptcy. The right to recover this three months' rent depends on whether there are sufficient assets on the leased premises, belonging to the bankrupt tenant, which can be sold to pay the landlord: s. 136(1)(f).

If a lease contains a clause which triggers an obligation by the tenant to pay accelerated rent upon its bankruptcy, then the priority given to the landlord under s. 136(1)(f) includes an additional claim for up to three months' accelerated rent. The landlord's right to priority for accelerated rent also depends on there being sufficient assets, belonging to the tenant, located on the leased premises to satisfy that claim.

The landlord is not entitled to claim rent for any portion of the unexpired term of the lease (subject to the claim for accelerated rent): *CTA*, s. 29(7).

(4) Impact On the Landlord's Right to Distrain

If distraint for rent has started, but not completed, before a tenant makes an assignment into bankruptcy then the bailiff must release the property seized, or the proceeds of sale (less the costs of distress and sale), to the tenant's trustee: *BIA*, s. 73(4).

If the rent distress has been completed and the landlord has been paid the proceeds of that distress, prior to the tenant's bankruptcy, then the trustee in bankruptcy has no recourse against the landlord unless the rent distress can be challenged as a fraudulent preference: *Thorne Ernst & Whinney Inc. v. Gazzola* (1986), 60 D.L.R. (4th) 590 (B.C.C.A.).

After the date of an assignment into bankruptcy, a landlord is not entitled to distrain the goods of the bankrupt tenant: *Commercial Tenancy* Act, R.S.B.C. 1996, c. 57 (the "*CTA*"), s. 29(8).

(5) Impact On the Landlord's Right to Pursue a Guarantor or Indemnitor

If a tenant goes bankrupt, and the trustee ultimately disclaims the lease, then the lease has come to an end. That disclaimer of lease will not, however, relieve an assignor of an assignee tenant in bankruptcy, or a guarantor of the lease, from their contractual liabilities. Guarantors and assignors remain liable: *Crystalline*

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Investments Ltd. v. Domgroup, 2004 S.C.C. 3.

The obligations of an indemnifier of a lease also do not come to an end simply because the trustee may disclaim and terminate the lease: *KKBL No. 297 Ventures Ltd. v. IKON Office Solutions Inc.*, 2004 B.C.C.A. 468. A contract of indemnity is a separate contract between the landlord and the indemnifier which stands alone and does not depend on the continuation of another contract (i.e. the lease agreement).

(6) Summary of Landlord's Rights on Tenant's Bankruptcy

	CAN	**CANNOT**
RENT	– file proof of claim in bankruptcy	– commence or continue legal action against the tenant: *BIA* s.69.3
	– claim priority for last three months' rent before bankruptcy: *BIA* s.136(1)(f)	– claim priority for all rent arrears
	– claim priority for up to three months accelerated rent if permitted by lease: *BIA* s.136(1)(f)	– claim rent or damages for balance of unexpired term: *CTA* s.29(7)
	– recover occupation rent if trustee actually occupies	– recover occupation rent if trustee disclaims lease
DISTRESS	– distrain before bankruptcy	– distrain after bankruptcy: *CTA* s.29(8)
	– claim compensation for cost of an incomplete distress: *BIA* s.73(4)	– keep property or proceeds from an incomplete distress: *BIA* s.73(4)
	– distrain for rent falling due during proposal period: *BIA* s.65.1(4)(a)	– distrain for rent which pre-dates proposal period
POSSESSION	– retake possession if lease is terminated before bankruptcy	– take possession while trustee holds for up to three months: *CTA* s.29(2)
	– retake possession if trustee disclaims lease: *CTA* s. 29(3)	– take possession if trustee assigns lease: *CTA* s.29(3)
GUARANTEE AND INDEMNITY	– pursue guarantor and indemnifier for arrears of rent and for future obligations even if trustee disclaims lease	

B. Companies' Creditors Arrangement Act

The *CCAA* is available to tenants who have claims against them in excess of $5,000,000. The *CCAA* gives larger businesses more flexibility and great periods of time to reorganize than do the commercial proposal sections of the *BIA*. The *CCAA* allows for custom-made reorganization structures by court orders, which can then be monitored through court applications.

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Unlike the *BIA*, there is no automatic stay of proceedings under the *CCAA*. Section 11 of the *CCAA* gives the court the discretion to order a stay of legal proceedings. Typically, the court will consider a stay of legal proceedings as a necessary step in any reorganization. The stay of proceeding will allow a tenant to remain in possession of the premises provided rent falling due after the date of the initial court order is paid.

While the claims of landlords are not specifically mentioned in the *CCAA*, some orders made under that Act have permitted companies to terminate leases even before approval of its reorganization plan. The Act may be used to prevent landlords from terminating leases or enforcing rights under leases: *Feifer v. Frame Manufacturing Corp.* (1947), 28 C.B.R. 124 (Que. C.A.). Unlike the *BIA*, there is no provision in the *CCAA* to compensate a landlord in the event the court authorizes a lease termination by the tenant, but the restructuring plan will include a formula for compensating the landlord.

The plan of compromise or arrangement for the tenant under the *CCAA* may deal with amounts owed to landlord's for arrears of rent and/or claims to future rent for the unexpired portion of the lease term: *Sklar-Pepplar Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.).

Under the *CCAA*, landlord's rights of distress and termination are typically stayed and tenants are often given the right to elect to abandon leases. Landlords, like other creditors can vote on a company's reorganization plan under the *CCAA* and the court must approve that plan.

VIII. AVOID FRAUDULENT CONVEYANCES AND PREFERENCES

A. Fraudulent Conveyance Act

A disposition of property made to delay, hinder or defraud creditors of their just and lawful remedies is void and of no effect against a person whose rights might be disturbed, hindered, delayed or defrauded by the conveyance: *Fraudulent Conveyance Act*, R.S.B.C. 1996, c.163 ("*FCA*"), s. 1.

The *FCA* does not apply to a disposition of property made to a purchaser who, in good faith, pays fair value for the property and who, at the time of the transfer, has no notice or knowledge of collusion or fraud: *FCA*, s. 2.

Where good consideration is given for a conveyance, the impeaching creditor must prove actual intent to defraud. Under the *FCA* there is nothing to prevent a debtor from preferring one creditor to another, provided that the security is given with that intent, was made for good consideration and was bona fide: *First Royal Enterprises Ltd. v. Armadillo's Restaurant Ltd. et al* (1995), 66 B.C.C.A. 170.

In *First Royal*, a landlord leased premises to a company operating a restaurant that fell into financial

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difficulty. The company's principal, became concerned about funds that he had advanced to the company. After being advised by his lawyer, the principal executed a promissory note and a general security agreement from the company to himself. The principal then advanced further funds but the restaurant did not prosper. The principal made a demand for the company to repay the loan and hired a bailiff to seize and sell the goods secured by the general security agreement. The landlord brought an action against the principal, claiming that the general security agreement was a fraudulent conveyance. The trial judge found in favour of the landlord and held that the general security agreement was void as a fraudulent conveyance. The principal appealed the decision and the Court of Appeal held in favour of the principal, finding that the actual advances of money at the time, the existence of the debt which had to be paid, the advice of the lawyer to take security for the debt, the registration of the general security agreement and the further advances of money on the reliance of the general security agreement were facts that all led to the conclusion that the general security agreement was executed in good faith, for the sole object of securing the money advanced and not with the intent on the party of the company to defraud creditors.

The Ontario High of Justice Court in *Solomon v. Solomon* (1977), 79 D.L.R. (3d) 264 at 274 summarized a list of features of transactions alleged to be made with fraudulent intent as badges of fraud:

1. Secrecy;
2. Generality of conveyances, by which is meant the inclusion of all or substantially all of the debtor's assets;
3. Continuance in possession by debtor;
4. Some benefit retained under the settlement to the grantor;
5. Gross excess of value of property over price paid;
6. Cash taken in payment instead of a cheque;
7. Unusual haste in closing;
8. No immediate or early change of possession following the conveyance or joint possession;
9. Knowledge on the part of the grantee of the grantor's insolvent circumstances, though by itself insufficient to impute to the grantee knowledge of the grantor's intent to defraud a creditor, is an important circumstance if there are other grounds for suspicion.

Each case must, however, turn on its own facts.

There is little that a creditor can do to prevent a tenant from transferring its assets to somebody else. Usually the tenant's creditors will not even be aware of the tenant's attempt to make himself "judgment proof" until after the creditor has obtained a judgment against the tenant and then attempted to execute on the judgment.

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A creditor who holds a judgment against the tenant can examine that tenant, under oath, about the tenant's current and former assets in an effort to find out about any such fraudulent transaction. If the creditor uncovers a fraudulent conveyance then steps can be taken by the creditor, against the tenant and the party to whom the tenant transferred the assets, to set aside the conveyance.

B. Fraudulent Preference Act

Any disposition of property (i.e. a gift, conveyance, assignment, transfer or delivery over of property) made with an intent to give one creditor a preference over another creditor, is void as against the injured creditor **if** it is made at a time when the debtor is in insolvent circumstances, unable to pay his debts in full or is on the eve of insolvency: *Fraudulent Preference Act*, R.S.B.C. 1996, c.164 ("*FPA*"), s. 3.

Under the *FPA*, a creditor is required to prove that the donor was insolvent or that he was unable to pay his debts in full, or that he was on the eve of insolvency. Under the *FCA*, all the applicant is required to prove is that the donor, in making the conveyance did so with intent to delay, hinder or defraud creditors: *Canadian Imperial Bank of Commerce v. Ash* (1964), 47 D.L.R. (2d) 620 (B.C.S.C.).

As a creditor of a tenant, a landlord can be affected by the *FPA*, in one of two ways:

1. the landlord may be the recipient of a fraudulent preference over the tenant's other creditors, or
2. the landlord may be the victim of a fraudulent preference given to one of the tenant's other creditors.

Landlord as recipient of preference: Although s. 136(1)(f) of the *BIA* gives a landlord a lawful preference for part of the rent owed by a tenant in bankruptcy, a landlord is generally an unsecured creditor of a tenant. If the landlord tries to gain an advantage over other secured creditors (e.g. by taking security for payment of an unsecured claim) then the landlord may be the recipient of a fraudulent preference, which can be attacked by other creditors of the tenant.

Landlord as victim of preference: The second scenario in which a landlord may come within the *FPA* is as the victim of a preference which the tenant may have given to one of his other creditors. If the landlord already holds a judgment against the tenant, then the landlord can challenge a fraudulent preference without having to commence a separate legal action. In those circumstances, the landlord may simply make application to court to force the tenant to show why the disposition of property should not be set aside: *FPA*, s. 9.

Generally speaking, sales and transfers of property which are made in good faith, for fair value, are not considered to be fraudulent preferences: *FPA*, s. 6.

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Where a disposition of property is challenged by a creditor within 60 days, the doctrine of pressure does not apply, otherwise, pressure asserted against the debtor is a defence: *FPA*, ss.4, 5; *Bank of Montreal v. Ngo* (1985), 66 B.C.L.R. 171 (S.C.). The Court in *Ngo* concluded with the following at p. 186:

Pressure need not be the sole ingredient which compels a debtor to part with his money or his property in favour of one creditor over another. A mere honest demand by a creditor for payment is sufficient to invoke the doctrine of pressure. For there to be preference, the payment by the debtor must be voluntary. Where there is pressure, the preference is not voluntary.

If a transaction is set aside as a fraudulent preference, then the property disposed of is returned to the debtor so it can be made available to all of the debtor's creditors for execution.

A trustee in bankruptcy can also make use of the provincial legislation to challenge a fraudulent preference although he will usually only do so if he is outside the time limits for challenging a transaction as a fraudulent preference under the *BIA*.

C. Bankruptcy and Insolvency Act

Under s.95.(1) of the *BIA* a transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person:

(a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against – or, in Quebec, may not be set up against – the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy; and

(b) in favour of a creditor who is not dealing at arm's length with the insolvent person, or a person in trust for that creditor, that has the effect of giving that creditor a preference over another creditor is void as against – or, in Quebec, may not be set up against – the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.

Under s.95.(2) of the *BIA*, there is a rebuttable presumption of a fraudulent preference if the **effect** of a conveyance, transfer, charge, payment, obligation or judicial proceeding referred to in 95.(1)(a) is to give one creditor a preference over another, even if it was made, incurred, taken or suffered, as the case may be, under pressure and evidence of pressure is not admissible to support the transaction.

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The words "*with a view to giving that creditor a preference*," have been judicially interpreted to indicate that it is the intention of the debtor that must be the subject of the inquiry: *Hudson v. Benallack* [1976] *2* S.C.R. 168; *Sharpe Cabinet Manufacturing Inc., Re* (1992), 18 C.B.R. (3d) 95 (B.C.S.C.).

Section 95.(1)(a) sets out three elements that must be proven by the trustee in its application to set aside the relevant transaction as a fraudulent preference. They are:

(a) that the payment in question was made to an ordinary creditor within three months of the bankruptcy;

(b) that the bankrupt was, at the date the payment was made, an insolvent person as defined under the BIA; and

(c) that the payment was made by the debtor "with a view to giving that creditor a preference over another creditor"

(Keith G. Collins Ltd. v. Canadian Imperial Bank of Commerce, [2010] 5 W.W.R. 56 (Man. Q.B)).

All transactions are considered to be valid unless and until they are set aside as a fraudulent preference.

The object of s.95 is to prevent a debtor from making a distribution of his property which would defeat the basic purpose of the *BIA* (i.e. that all ordinary creditors should share equally).

Subject to secured creditors, payment of rent to the landlord for the three months immediately preceding the date of bankruptcy cannot be attacked as a fraudulent preference since the landlord is a preferred creditor for that amount pursuant to s. 136(1)(f) of the *BIA*.

Amounts paid to a landlord for arrears of rent for the period **prior to** the last three months before bankruptcy can, however, be attacked as a fraudulent preference, because the landlord is not a preferred creditor for arrears incurred before that last three months.

Payments received by a **secured** creditor under a valid security document in the three months preceding bankruptcy cannot be attacked as a fraudulent preference.

Section 95 applies to six different kinds of transactions:

1. a conveyance or transfer of property,
2. a provision of services made,
3. a charge on property (e.g. the giving of security),

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4. a payment made,
5. an obligation incurred, and
6. a judicial proceeding taken or suffered.

A distress by a landlord is a judicial proceeding suffered by a debtor. If a debtor who is being pressed by his creditors permits a landlord to proceed with a distress and obtain a preference over other creditors, then the distress is a fraudulent preference. The debtor could have prevented the landlord from obtaining a preference by making an assignment into bankruptcy, and if he fails to make an assignment into bankruptcy in order to give the landlord a preference then the rent distress can be set aside under s. 95(1). If the rent distress is set aside then the landlord will still be entitled to retain three months' rent as the preference that the landlord is entitled to have by reason of s. 136(1)(f).

Section 95 can only be invoked if the conveyance, transfer, payment, etc., was made by an "insolvent person". A person is deemed to be insolvent if:

(a) he is unable to meet obligations generally as they become due,

(b) he has ceased paying current obligations in the ordinary course of business, or

(c) his assets are insufficient to pay his obligations.

IX. ABANDONMENT OF PREMISES AS A LAST RESORT (THE MIDNIGHT RUN)

A. Avoid a Fraudulent Removal of Goods Under Distress

Sections 11 to 15 of the *RDA* create a statutory exception to the general rule that a distraint is limited to goods found on the premises. If a tenant fraudulently or clandestinely removes personal property from the leased premises, to prevent the landlord from distraining for arrears of rent, then the landlord may follow those goods for up to 30 days and seize them, wherever found: *RDA* s. 11.

A tenant who fraudulently removes or conceals his property from the landlord can be liable to pay to the landlord double the value of the property carried off or concealed: *RDA* s. 13; *Levinson-Viner Ltd. v. Gaudreau* (1984), 33 R.P.R. 34 (Ont. H.C.). Once the fraud has been established, the imposition of the penalty at an amount equal to double the value of the property removed is mandatory: *Park Street Plaza Ltd. v. Bhamber* (1992), 23 R.P.R. (2d) 288 (Ont. Gen. Div.) at 291.

In *Sun Life Assurance Co. of Canada v. Ritchie*, 2000 BCCA 231, leave to appeal refused, 2000 S.C.C.A. No.

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247, the B.C. Court of Appeal considered whether goods subject to a security interest under s. 178 of the *Bank Act*, S.C. 1991 c. 46, fell within the meaning of "personal property" in s. 13 of the *RDA*. Section 178 of the *Bank Act* grants the bank legal title to the debtor's interest in all present and after acquired property. The debtor, however, retains an equitable right of redemption in the property. The B.C. Court of Appeal held that the tenant's remaining equitable right in the goods, combined with its possession of them and the right to sell the goods in the ordinary course of business, brought the goods within the meaning of "personal property" in s. 13 of the *RDA*.

The penalty for fraudulently removing or concealing property is not simply available against the tenant but is also available against "every person who wilfully and knowingly aids the tenant or lessee in doing so": *RDA* s. 13. In Ontario, a similar provision has been used to find the principal shareholder of a tenant personally liable for double the value of the stock removed: *General Leaseholds Ltd. v. 661255 Ontario Inc.* (1990), 15 R.P.R. (2d) 311 (Ont. Div. Ct.). A landlord was similarly successful against a company, including its "controlling mind", which purchased goods of a tenant to intentionally frustrate the landlord's right to distress: *CD Plus.Com Inc. v. Concorde Group Inc.*, 2002 SKQB 346, reversed in part on appeal, 2004 SKCA 1. On appeal, the Saskatchewan Court of Appeal reduced the amount of the judgment awarded to the landlord. A landlord can only recover double the value of those purchased goods which were properly subject to the landlord's right of distress. See also *Nebete Inc. v. Sanelli Foods Ltd.* (1999), 24 R.P.R. (3d) 114 (Ont. Gen. Div.).

In a case involving a provision similar to s. 13 of the *RDA*, the Ontario Superior Court of Justice was asked to consider what degree of probability is required to meet the civil burden of proof in cases of this nature. In *1268227 Ontario Ltd. (c.o.b. Seamus O'Briens) v. 1178605 Ontario Inc.*, [2001] O.J. No. 3642, affirmed by [2003] O.J. No. 2002 (Ont. C.A.), the court lacked direct evidence linking the individual defendants to the fraudulent removal of goods from premises leased to a corporate tenant. There was, however, significant circumstantial evidence before the court which indicated that the individual defendants were the parties responsible for the fraudulent removal of the goods. In her reasons, Madame Justice Croll noted that the "penal nature" of the provision and its "stigma of dishonesty" required a "…degree of probability…commensurate with the occasion" (para. 37). A determination of whether the required degree of probability has been met should be made in light of the whole of the circumstances of the case.

If a landlord, or his bailiff, finds property which has been fraudulently or clandestinely removed and locked up or secured in another location then, after calling the police to assist, the landlord or bailiff may forcibly break in and seize the property fraudulently secured in that other location; *RDA* s. 15.

These sections of the *RDA* provide a limited and specific exception to the general rule that there is no right

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of distress for tenant's goods which are not located on the leased premises. It is a statutory right and landlords must comply strictly with its provisions in order to claim the benefit of this exception to the general rule; *Lawrence Ave. Group Ltd. v. Factory Carpet Co.* (1992), 23 R.P.R. (2d) 156 (Ont. Gen. Div.). In the *Lawrence Ave.* decision, the landlord purported to distrain in this manner outside the 30 day period permitted by the statute. On that basis, the distress was invalid and the tenant was entitled to a return of the goods distrained.

B. Understand Damages Arising From Breach of an Operating Covenant

The rules for the assessment of damages for a breach of contract apply when assessing damages for a tenant's breach of an operating covenant in a lease. When assessing damages for breach of an operating covenant by a tenant, the landlord is to be put in the same position it would have been in if the tenant's breach had not occurred.

If a tenant has breached an operating covenant in a lease, the landlord may sue the tenant for damages. Damages landlords typically claim for breach of an operating covenant include:

- loss of unpaid future rent (basic, additional and percentage rent) from the tenant at present value (assuming the tenant has ceased operations and stopped paying rent);
- loss of rental income from other tenants of the shopping centre based on the loss of percentage rent paid by other tenants resulting from the tenant closing its store, the inability to attract new tenants to the centre, and the inability to obtain the renewal of leases from existing tenants;
- loss in value of the shopping centre; and
- any other losses that can be proved by the landlord.

Note that it will be difficult for landlords to prove loss of rent, particularly in situations where the tenant is no longer operating but continues to pay rent and either is not obligated to pay percentage rent or never generated enough sales to require the tenant to pay percentage rent.

Given the difficulty, if not impossibility, of obtaining an injunction to compel a tenant to honour its operating covenant, and the difficulty of assessing damages arising from a tenant's breach of an operating covenant, some landlords have added provisions to the operating covenant requiring the tenant to pay a daily charge, in addition to ordinary rent, if the operating covenant is breached. If the daily charge is a genuine pre-estimate of damages, and not a penalty, then such liquidated damages clauses are enforceable: *Dunlop Pneumatic Tyre Co. v. New Garage and Motor Co. Ltd.*, [1915] A.C. 79 (H.L.); *Canadian General Electric Co. v. Canadian Rubber Co.* (1915), 52 S.C.R. 349.

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The basic contract principle behind measuring the amount of damages to which the landlord is entitled (i.e. put that the landlord in as good a position as he would have been had there been proper performance of the lease) is qualified by the requirement that a tenant should not be required to pay avoidable losses that would result in an increased amount of damages payable to the landlord. The imposition of this duty to mitigate on a landlord, however, only arises if the landlord choses to terminate the lease in response to the tenant's breach. It does not arise if the Landlord simply affirms the lease and sues for unpaid rent as it falls due.

If a landlord chooses to terminate a lease and seeks damages thereafter, the landlord has a duty to try to mitigate its loss. An example of a landlord mitigating its loss when terminating a lease would be finding a new tenant and offsetting the amount owing by the former tenant by the amount the landlord receives from the new tenant. A landlord or its leasing agent should therefore keep a record of all efforts to re-let the premises after termination, including with respect to money spent to advertise or repair the premises in order to attract new tenants.

If the landlord has a duty to mitigate its losses, the landlord is held to a standard of reasonableness such that it is the tenant's responsibility to prove the landlord's efforts to mitigate were not reasonable: *1039198 Ontario Inc. v. Ash Pharmacies Inc.,* [1998] O.J. No. 4397, at para. 109.

If the lease is not terminated by the landlord, however, the situation is different. In *Transco Mills et al v. Percan Enterprises Ltd.* (1993), 76 B.C.L.R. (2d) 129 (C.A.), at p. 370 the Court of Appeal states *"[t]here is no basis on which a landlord of commercial premises can be required to mitigate its loss where it maintains the lease in existence and claims for rent due."* This case determined that a landlord who has chosen to preserve a lease and sue for rent, not damages, has no duty to mitigate and accordingly, the landlord did not have to collect rent from a sub-tenant that was occupying the premises without the landlord's authority.

X. SUMMARY

Desperate circumstances often lead to poor decisions that may simply make a bad situation worse. Understanding the rights of different creditors, the potential liability of a tenant and the personal liability of its directors, can help a tenant develop a plan for dealing with creditors in an orderly fashion.

If the tenant's creditors are overly aggressive, and won't provide time for the tenant to come up with a plan, then consider the benefits of corporate reorganizations and insolvency protection available under insolvency legislation.

At all costs, the tenant must avoid the temptation to secure an advantage through a fraudulent preference,

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conveyance or removal of property.

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