BEST PRACTICES FOR COMMERCIAL LANDLORDS FACING TENANT INSOLVENCIES (ADAPTED TO THE PROVINCE OF QUÉBEC)

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Many commercial landlords are increasingly alarmed that COVID-19 may cause a surge in tenant bankruptcies or restructurings. We outline below the major issues for landlords arising from tenant defaults and insolvencies and suggest best practices to minimize losses. We also outline each of the main insolvency or restructuring proceedings which could involve a corporate tenant, including bankruptcies under the *Bankruptcy and Insolvency Act* ("**BIA**"),[1] receiverships, proposals under the BIA and proceedings under the *Companies' Creditors Arrangement Act* (the "**CCAA**")[2] and how such proceedings may impact the rights and financial position of the landlord. For the purposes of this article we will refer to each of these proceedings as insolvency and restructuring proceedings.

Know Your Lease Terms

We highlight below the major issues landlords commonly face upon the insolvency of a tenant. However, any particular landlord's rights will depend in great part on the actual terms of the lease. As such, the starting point for any landlord should be a careful review of the lease and any related documents, such as guarantees or indemnities.

What To Do If You Suspect Impending Tenant Insolvency

A tenant is generally considered insolvent if it cannot pay its debts or liabilities as they come due. Landlords who suspect or become aware that their tenants are in serious financial difficulty may consider a number of options to better protect the landlord's interests and financial position. For example, and depending on the specific circumstances, landlords could consider:

- granting rent relief, which is often accomplished by negotiating a suspension or deferral of rent payments. This can allow a tenant to continue as a tenant of the landlord;
- granting waivers of certain terms of the lease, which could allow a tenant to wind down its business in an orderly manner outside of an insolvency or restructuring proceeding. Often commercial lease terms for

retail tenants will have prohibitions on tenant liquidation or going out of business sales. By negotiating specific waivers, landlords can retain a certain level of control and oversight of a tenant's liquidation or business closure, and avoid the stigma of a tenant undergoing an insolvency or restructuring proceeding;
- adding accelerated rent provisions into the lease that will be enforceable in a tenant bankruptcy or restructuring;
- obtaining additional guarantees or indemnities from third parties that will be enforceable if the tenant defaults on the lease or undergoes an insolvency or restructuring proceeding;
- terminating the lease before the tenant undergoes a bankruptcy or insolvency proceeding. If a landlord waits until an insolvency or restructuring proceeding has begun, the landlord must get the consent of the tenant and any court officer overseeing the insolvency or restructuring proceeding, or court order, to terminate the lease.[3]

However, government restrictions may affect a landlord's ability to terminate the lease.[4]

How Does a Tenant Insolvency Affect the Lease?

Generally, restructuring proceedings such as a proposal under the BIA or a proceeding under the CCAA allow tenants to remain in control of and continue to operate their businesses. The implications for landlords of these types of proceedings can be different from proceedings such as receiverships or bankruptcies under the BIA, which often involve the liquidation of the assets of the tenant by a court officer. We discuss each of these types of proceedings below. Additional options, such as out of court settlements and restructurings under corporate statutes may also be options, but are beyond the scope of this article.

(1) BIA – Proposal

Under this route, the tenant can generally seek to sell its business as a going concern or make a formal offer to settle with its creditors. The tenant remains in possession of and often continues to operate its business during this process under the supervision of a court officer called a Proposal Trustee. A proposal proceeding under the

BIA typically has the following major effects on the rights of landlords and tenants:

- there is an automatic stay of proceedings upon filing a notice of intention to make a proposal, which means that the landlord cannot start or continue a lawsuit for arrears (subject to certain exceptions) during the proposal period;[5]
- the tenant may occupy the premises during the proposal period so long as it pays post-filing rent;[6]
- the landlord cannot terminate the lease without either: (1) the consent of the tenant and the court officer overseeing the proposal proceeding; or (2) a court order finding that continuing the lease would cause

undue financial hardship to the landlord;[7]
- the tenant continues to be bound by the terms of its lease unless the tenant disclaims the lease on 30 days' notice to the landlord;[8]
- the landlord may object to the disclaimer on the basis that it is not necessary for the proposal to be financially viable;[9] and
- disclaiming the lease effectively ends the tenant's rights, interests and liabilities under the lease going forward. The landlord has no claim for accelerated rent, and the proposal will specify whether the landlord can claim its losses arising from the disclaimer.

Once the proposal is filed, creditors with proven claims will vote to accept or reject it. If 50% of the creditors in number and two-thirds of the creditors in value vote in favor of the proposal, it is deemed accepted, subject to court approval.[10] If the proposal is refused, the debtor is automatically deemed bankrupt.[11]

(2) CCAA – Restructuring

An insolvent tenant can also seek relief under the CCAA, which often provides a more flexible court-supervised restructuring process than the proposal proceeding under the BIA. The tenant remains in possession of and often continues to operate its business during this process under the supervision of a court officer called a Monitor. Seeking relief under the CCAA is only available for tenants owing at least $5 million.[12] CCAA proceedings have the following major impacts on leases:

- there is no automatic stay of proceedings, but a tenant will typically obtain one through court order at the beginning of the proceedings;[13]
- the tenant must pay post-filing rent unless or until it disclaims or assigns the lease;[14]
- as a matter of practice, courts permit the tenant to disclaim (on 30 days' notice to the landlord) or assign (without the landlord's consent, so long as all monetary defaults are cured) the lease; and
- the landlord may object to the disclaimer[15] or assignment.[16]

Damages to the landlord flowing from disclaimer are treated as unsecured claims.[17] A number of very high profile CCAA proceedings in recent years have been motivated in part by debtor companies seeking to disclaim expensive leases.

(3) BIA - Voluntary Assignment in Bankruptcy or Involuntary Bankruptcy Order

A bankruptcy of a tenant under the BIA vests all the tenant's assets in a court officer called the Trustee in Bankruptcy. In this case, the tenant no longer operates the business. The Trustee becomes responsible for liquidating the tenant's assets and distributing the proceeds to the tenant's creditors.

Bankruptcy has the following major effects on the rights of landlords and tenants:

- there is an automatic stay of proceedings,[18] and the Trustee may occupy the premises so long as it pays post-filing rent;[19]
- in certain PPSA provinces, within a three-month period after the assignment or bankruptcy order is made, the Trustee must elect to disclaim the lease, retain the leased premises for the whole or a portion of the balance of the term, or assign the lease (with court approval);[20]
- the landlord can file a proof of claim for its actual losses resulting from the disclaimer or for a percentage of lost rent;[21]
- if the Trustee assigns the lease, any amounts then-owing under the lease must be paid in full.[22]

In a bankruptcy, various debtor's claims are paid in a specific priority. The landlord's preferred claim for arrears is paid after the secured creditors and certain other preferred creditors (e.g. the Canada Revenue Agency) are paid in full. The preferred claim is limited to: (i) arrears of rent for three months owing before the bankruptcy; and (ii) an additional three months accelerated rent, if provided for in the lease. Any assets located on the premises are sold and the proceeds are used to pay the landlord's claim. The total amount recovered cannot exceed the sale proceeds.[23] For amounts still owing on top of the preferred claim, the landlord ranks as an unsecured creditor.[24]

(4) Receivership

A receiver can be appointed in respect of the assets and undertakings of a tenant pursuant to: (1) a security agreement granted to a secured creditor; this is referred to as a private receiver; or (2) pursuant to a court order granted under the BIA or certain provincial legislation; this is referred to as a court appointed receiver. Generally speaking, receivers will take control of and sell the tenant's property to satisfy debts of creditors.

Privately-Appointed Receiver (PPSA Provinces only). Where a security agreement provides for a privately-appointed receiver, the powers of the receiver will be set out in that agreement. For example, a security agreement will virtually always contain a "deemed agency clause" that will allow the receiver to act as "agent" of the debtor. Importantly, the duties of private receivers are to secured creditors, not the debtor or the landlord. A privately appointed receiver is essentially an agent of a creditor enforcing a security agreement. In such cases, landlords retain all of their rights in respect of the tenant.

Court-Appointed Receiver. Section 243 of the BIA and certain provincial legislation gives the court the power to appoint a receiver if it is equitable and just in the circumstances.[25] The court order appointing the receiver sets out the powers of the receiver, which will normally include the power to take control of the property, carry on the debtor's business, and liquidate assets under the court's supervision. Unlike private receivers, court- appointed receivers are officers of the court and accountable to all interested parties, but are generally appointed by the secured creditors of the tenant.

Best Practices for Landlords when Tenants Commence Insolvency or Restructuring Proceedings

Once a landlord learns that a tenant is in an insolvency or restructuring proceeding, it is critical that the landlord act quickly. The landlord should consider:

- immediately drawing on any letters of credit, if possible;[26]
- taking action against any lease guarantors or indemnifiers. Claims against guarantors and indemnifiers are not limited by bankruptcy proceedings, although they could be affected by CCAA court orders;
- taking the necessary steps to ensure that it receives all information available to creditors by, for example, ensuring that the Proposal Trustee, Monitor, Trustee or the receiver has the landlord's contact information and the landlord or its counsel are added to any services lists used to deliver court documents in the proceedings;
- finding out the answers to a few important preliminary questions, such as:
    - what type of proceeding is it?
    - where is the proceeding taking place? This will impact whether the landlord needs to retain counsel in the province where the proceeding was commenced. In addition, both the CCAA and BIA provide for the coordination of cross-border restructuring proceedings,[27] which can significantly impact the rights of a landlord if the insolvency or restructuring proceeding was commenced outside of Canada under legislation that grants different rights to landlords than Canadian legislation.
    - what is the next most important date? For example, is there a court hearing coming up? Is there a deadline to submit a document such as a proof of claim that needs to be met?
- communicating any concerns or legal issues to the tenant and/or the court officer in a timely manner. Given the speed at which insolvency proceedings can progress, if a landlord waits to retain counsel or communicate its position, the opportunity to do so may be lost;
- ensuring that any proofs of claim are submitted on time. Failing to submit a proof of claim on time in an insolvency or restructuring proceeding may result in the landlord not being able to vote on the proposal of the tenant to its creditors, or may result in a total bar to the landlord's claim against the tenant. For this reason, it is crucial that landlords keep and review all documents delivered by tenants or court officers in insolvency and restructuring proceedings; and
- preparing a plan for leasing the premises in the event that the tenant disclaims the lease.

[1] *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s 65.11(1) [BIA].
[2] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, s 3(1) [CCAA].
[3] *BIA*, s 65.11(1).
[4] E.g. Legislation in Ontario has barred landlords in certain circumstances from terminating leases or

distraining due to non-payment of rent. Note that in PPSA provinces, landlords also have the benefit of a right of distress, which does not exist under the Civil code of Quebec.
[5] *BIA*, s 69(1).
[6] *Cosgrove-Moore Bindery Services Ltd, Re*, (2000) 48 OR (3d) 540 (Ont SCJ). Note that the model CCAA Orders, which are different in each province, may have a term that rent is payable twice monthly. However, the terms of the actual order granted in a CCAA proceeding will govern.
[7] *BIA*, s 65.1(1) and 65.1(6).
[8] *BIA*, s 65.2(1).
[9] *BIA*, s 65.2(3).
[10] *BIA*, s 54(1).
[11] *BIA*, s 57.
[12] *CCAA,* s 3(1).
[13] *CCAA*, s 11.
[14] *CCAA*, s.11.01.
[15] The objection may be on the basis that the disclaimer of the lease does not enhance the restructuring.
[16] The objection may be on the basis that the assignee is unable to meet its obligations under the lease or the assignee is not an "appropriate person" (for example, if the assignee intends to use the premises in a manner contrary to the lease).
[17] *CCAA*, s. 32(7).
[18] *BIA*, s 69.3(1).
[19] *Commercial Tenancies Act*, RSO 1990, c L7, s 38(2) [*CTA*]. Note that in the Province of Quebec the courts have generally recognized that "ipso facto" clauses, which permit the termination of a lease upon a tenant's bankruptcy, are in fact effective against a trustee in bankruptcy.
[20] CTA, s 38(2); *Commercial Tenancies Act*, RSBC 1996, c 57, s 29 [*BC CTA]*; *Landlord's Rights on Bankruptcy Act*, RSA 2000, c L-5, ss 8-9 [*LRBA*]. There is no such right under the Civil code of Quebec.
[21] *BIA* s 65.2(4).
[22] *CTA*, s 38(2); BC CTA, s 29(3); LRBA, s 8(2)(b).
[23] *BIA*, s. 136(1)(f)).
[24] BIA, s 136.
[25] *Lemare Lake Logging v 3L Cattle Company*, 2013 SKQB 278.
[26] *7636156 Canada Inc v OMERS Realty Corporation*, 2019 ONSC 6106.
[27] Provisions are based on the UNICITRAL Model Law on Cross-Border Insolvency, similar to Chapter 15 of the US Bankruptcy Code.

by Laura Brazil, Kourtney Rylands, Michael Hanlon and Maya Provad

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.