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# COMMERCIAL LANDLORD AND TENANT INSOLVENCIES: THE NEED TO KNOW FOR SUB-TENANTS

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At the outset of the COVID-19 pandemic, provincial emergency orders required the majority of businesses to migrate their workforce to a work-from-home environment. As the pandemic has persisted, what was originally a short-term solution for many businesses, has led many of them to reconsider their current and future need for office space. For those businesses tied into long-term leases, many have turned to subleasing all or a portion of their space as a way to reduce their overhead. In fact, in Toronto, office space available to sublease quadrupled in 2020.[1]

Although subleasing office space may alleviate some financial pressure, the COVID-19 pandemic continues to put enormous strain on many businesses. As the economy begins to reopen and government and lender support programs wind down, it is particularly important for sub-tenants and landlords to consider the ramifications of an insolvent head-tenant.

To that end, we discuss below key statutory provisions regarding sub-lease agreements in an insolvency.

**Disclaimer of a Lease: The *CCAA, BIA, and CTA***

When any company reaches the point of insolvency, a key preliminary step is considering what agreements the debtor company should maintain, and what tools the debtor company, or the trustee in bankruptcy, has to address undesirable agreements. One such tool is the right to disclaim agreements pursuant to the *Companies' Creditors Arrangement Act* (the "***CCAA***") and the *Bankruptcy and Insolvency Act* (the "***BIA***"). However, this right contains certain exceptions, including those applicable to commercial landlords and their tenants.

A commercial landlord's right to disclaim a lease is prohibited under the *CCAA*. Section 32 permits a debtor company to disclaim any agreement to which the company is a party. However, s. 32(9)(d) holds that this right does not apply in respect of a lease of real property if the debtor company acts as the landlord. Accordingly, a tenant may disclaim a lease under the CCAA but a landlord is prohibited from doing so.

Similarly, although a debtor company that files a proposal or notice of intent to file a proposal under the *BIA*

obtains the power to disclaim certain agreements pursuant to s. 65.11 thereof, this right does not extend to a lease of real property if the debtor is the landlord.

The same is true in the context of a debtor company's bankruptcy in Ontario. Section 30(1)(k) of the *BIA* grants the trustee in bankruptcy the power, with the permission of the inspectors of the bankrupt estate, to disclaim any lease of, or other temporary interest or right in, any property of the bankrupt. However, there is an explicit carve-out under s. 146 of the *BIA* in respect of the right's of landlords. The section provides that the rights of lessors are to be determined according to the law of the province in which the leased premises are situated.

In Ontario, the *Commercial Tenancies Act* (the "***CTA***") is the governing statute between commercial landlords and tenants. Pursuant to the *CTA*, a landlord has no statutory authority to unilaterally terminate a lease of a tenant, who is in compliance with their obligations.[2] While s. 39 of the *CTA* grants the trustee of a bankrupt tenant the right to disclaim a lease, this section does not afford a commercial landlord the right to do the same.

Although the CCAA does not contain an explicit carve-out, the CCAA ought to be interpreted in a similar fashion to the *BIA* in the context of landlord and tenant matters. When the CCAA, as a piece of federal legislation, can be properly interpreted so as not to interfere with a provincial statute, such an interpretation should be applied.[3] The CCAA is likely to be interpreted harmoniously with provincial landlord and tenant legislation because the CCAA does not provide specific guidance on landlord and tenant issues.

**Disclaimer of a Lease: Sub-tenancy**

The *BIA* and *CCAA* provisions referenced above apply where a company, as a tenant, has entered into a sublease agreement with a third party. As noted above, under both the *BIA* and *CCAA* the debtor company has the ability to disclaim the head-lease in its capacity as a tenant. The debtor's disclaimer of the head-lease does not, however, automatically terminate the sub-lease.[4]

The *CTA* provides redress to a sub-tenant where the debtor has disclaimed the head-lease in its capacity as a lessee of real property. Pursuant to s. 39(1), where a tenant has entered into a sublease agreement with a third party prior to its insolvency, with the consent of the head-landlord, the sub-tenant may elect to remain in occupation of the premises. If the sub-tenant elects to do so, the sub-tenant stands in the same position as if they were the direct tenant of the head-landlord.[5] The sub-tenant will then have the same obligations to the head-landlord as the debtor had, except that the rent payable by the sub-tenant is required to be the greater of (a) the rent paid by the sub-tenant to the debtor under the sub-lease, or (b) the rent paid by the debtor to the head-landlord under the head-lease.

**Termination of the Head-Lease: Sub-tenancy**

Although a debtor may avoid a bankruptcy or restructuring, it may nevertheless default under the head-lease.

Triggering an event of default clause may permit the landlord to terminate the agreement. Absent a non-disturbance agreement between the landlord and the sub-tenant, the landlord's termination of the head-lease results in a termination of the sub-lease.

However, the *CTA* protects sub-tenants in this situation. If a landlord is exercising a right of re-entry or forfeiture under the head-lease, s. 21 of the *CTA* allows a sub-tenant to apply to a court to obtain an order permitting it to remain in the premises as a direct tenant of the landlord. The court has discretion on the new leases terms, including, but not limited to, the payment of rents, costs, expenses, damages, and compensation. The only caveat is that term of the new lease cannot be any longer than the term under the original sub-lease.

A party's entitlement to disclaim or terminate certain agreements is just one of many issues to consider in an insolvency situation. Please contact McMillan for further guidance on navigating a bankruptcy or restructuring in the commercial real estate industry.

[1] *Downtown T.O. office sublease space quadruples in 2020.*
[2] *Business Development Bank v Adventura II Properties Inc*, 2015 ONSC 5026.
[3] *Crystalline Investments Ltd v Domgroup Ltd*, [2004] 1 SCR 60.
[4] *Berkley Property Management Ltd v Garden City Plaza Ltd*, 1995 CarswellAlta 274.
[5] *Roanne Holdings Ltd v Victoria Wood Development Corp*, 1975 Carswell.

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**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.