ENDING THE UNCERTAINTY IN COMMERCIAL LEASE OBLIGATIONS OF INSOLVENT TENANTS? *CRYSTALLINE INVESTMENTS LTD. V. DOMGROUP LTD.*

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I. INTRODUCTION

IN January of 2004, the Supreme Court of Canada (the SCC) handed down a decision in *Crystalline Investments, Ltd. v. Domgroup Ltd.*[1] (*Crystalline*) that significantly affected landlord-tenant law under the Bankruptcy and Insolvency Act. Specifically, the decision signaled the SCC's view of a landlord's rights as against a guarantor or other third party surety of a tenant's lease when the tenant disclaims the lease under the Bankruptcy and Insolvency Act (the Act or the BIA). In the *Crystalline* decision, the Court attempted to put an end to the legal uncertainties created forty years before by *Cummer-Yonge v. Fagot* (*Cummer-Yonge*) and by the successive provincial cases addressing the issues raised by *Cummer-Yonge*.[2]

II. *CRYSTALLINE INVESTMENTS, LTD. V. DOMGROUP LTD.*

A. BACKGROUND

Crystalline dealt with an assignor of a commercial lease and its responsibilities after the assignee's repudiation of the lease under the BIA and provincial legislation. Domgroup executed a twenty-five year commercial lease with Crystalline Industries Limited (Crystalline Industries or, collectively with Burnac, the landlords) in 1979 and with Burnac Leaseholds Limited (Burnac or the landlords) in 1980.[3] Both leases contained an assignment clause that stated: "Notwithstanding any assignment or sublease the Lessee shall remain fully liable under this lease and shall not be released from performing any of its covenants, obligations or agree-

* J.D., Southern Methodist University, 2006. This article was written in the fall of 2004 and does not reflect any recent developments in the law.

1. Crystalline Invs., Ltd. v. Domgroup Ltd., [2004] S.C.R. 60.
2. Jay Carfagnin, Ken Herlin, & Scott Bell, *SCC Goes Out of Its Way To Over-Rule* Cummer-Yonge, GOODMANS UPDATE (Goodman's LLP, Toronto), Apr. 20, 2004, at 1, http://www.goodmans.ca/index.cfm?fuseaction=PublicationDetail&primaryKey= 265.
3. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 11.

ments in this lease and shall continue to be bound by this lease."[4]

In 1985, Domgroup assigned the leases to a subsidiary, Coastal Foods, which would later become Food Group.[5] Food Group subsequently became insolvent. In 1994, Food Group filed a proposal under the Act.[6] The proposal included terminating the leases with Crystalline Industries and Burnac, and the trustee for Food Group notified the landlords of the intention to repudiate the lease.[7] The Court of Queen's Bench for New Brunswick in Bankruptcy approved Food Group's proposal in March of 1994.[8] The trustee paid the landlords the equivalent of six month's rent pursuant to section 65.2(3) of the Act, and as of March 31, 1994, the repudiation was declared to be effective.[9] The next year, Burnac and Crystalline Industries informed Domgroup of their intention to assert their rights under the assignment clause against Domgroup, as the original tenant, for payment of accrued rent under the lease.[10] The notification did not acknowledge that the leases had been terminated as of March 31, 1994.[11]

Domgroup did not pay, and the landlords brought suit in Ontario court.[12] In its defense, Domgroup moved for summary judgment in both cases on claims that assignors should be treated the same as guarantors under the BIA.[13] It reasoned that because it assigned the lease to another and was no longer in possession of the premises, it had become a third party surety of Food Group, the tenant in possession, and nothing more than that. Consequently, Domgroup claimed, because the lease had been terminated, Domgroup had no more obligations to Crystalline or Burnac. At the trial level, Domgroup was successful.[14] According to the Ontario Superior Court of Justice, the court's approval of the termination of the leases ended the obligations of the parties under the leases and therefore the landlords had no basis in law for their claims against Domgroup.[15]

The Ontario Court of Appeals reversed, finding that "the repudiation of an assigned commercial lease by an insolvent tenant . . . under s.65.2 of the [BIA] . . . did not affect the original lessee's obligations to the landlord."[16] Instead, the original tenant remains liable for its obligations in

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4. *Id.*
5. *Id.* ¶ 12.
6. *Id.* ¶ 14.
7. *Id.*
8. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 16.
9. *Id.*
10. *Id.* ¶ 19.
11. *Id.*
12. *Id.* ¶ 20.
13. Crystalline Invs., Ltd. v. Domgroup Ltd., [2001], 31 C.B.R. (4th) 216 ¶ 1 (Ont. Sup. Ct. J.).
14. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 7.
15. *Id.* ¶ 23.
16. CLE Staff, *SCC Holds Assignors of Commercial Leases to Bankrupt Tenants Liable to Landlords* (Continuing Legal Educ. Soc'y of British Colombia, Stay Cur-

the lease unless contractually released by the landlord.[17] The case was then appealed to the Supreme Court of Canada, which affirmed.

B. The Supreme Court of Canada Decision

The Supreme Court held that "the repudiation must be construed as benefiting only the insolvent."[18] The Court held that while a repudiation of the lease by the assignee tenant under the BIA ends the assignee tenant's obligations to pay rent under the lease, the original tenant remains bound by all of the conditions of the lease.[19] According to the court, the purposes of section 65.2 of the BIA are to "free an insolvent from the obligations under a commercial lease that have become too onerous, to compensate the landlord for the early determination of the lease, and to allow the insolvent to resume viable operations as best it can."[20] The Court concluded that nothing in the BIA was meant to protect third parties, "i.e. guarantors, assignors, or others," from their responsibilities when a commercial tenant becomes insolvent.[21] Instead, third parties that make guarantees on behalf of tenants who later become insolvent remain liable.[22] With respect to assignors of leases, assignors remain in privity of contract with the landlord despite no longer having privity of estate, and as such the original tenant remains liable for the obligations under the lease in the event that the assignee does not pay rent.[23]

Crystalline dealt specifically with an assignor of a lease, rather than a guarantor or other party surety of the lease. But the Court went on in what is arguably dicta to address the issue of what the obligations of third party sureties should be after the tenant-in-possession becomes insolvent and disclaims or repudiates the lease as a result of the insolvency.[24] The Court addressed a leading provincial case, *Cummer-Yonge*, on which forty years of precedent had been built, and went on to state that *Cummer-Yonge* should be overruled.[25]

The Court expressed doubt as to "whether there is any justification for distinguishing between a guarantor and an assignor post-disclaimer."[26] According to the Court, the *Cummer-Yonge* rule caused uncertainty in bankruptcy and leasing, leading drafters of leases to create ways around

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rent), Jan. 29, 2004, http://www.cle.bc.ca/CLE/Stay+Current/Collection/2004/1/04-scc-crystalline.htm.

17. Brian Clark & Jeffrey W. Lem, Cummer-Yonge: *The Eulogy—A Commentary on* Crystalline Investments Limited v. Domgroup Ltd. (Ontario Bar Association), http://oba.org/en/rpr/mar04/cummer.aspx (last visited Sept. 23, 2004).
18. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 27.
19. Brenda Hollingsworth, *Supreme Court Increases Security for Landlords* (BrazeauSeller, Articles, Ontario), June 10, 2004, http://www.brazeauseller.com/articlessearch results.asp?nav=2&mode=3&id=2004 (on file with author).
20. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 28.
21. *Id.*
22. *Id.*
23. *Id.* ¶ 29.
24. Clark & Lem, *supra* note 17.
25. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 42.
26. *Id.* ¶ 37.

the ruling and courts to make "'tortuous distinctions'" in order to hold guarantors to their liability under the lease.[27] The Court considered a similar case in England, *Hindcastle Ltd. v. Barbara Attenborough Associates Ltd.* (*Hindcastle*), which had overruled *Stacey v. Hill*, the English equivalent of *Cummer-Yonge*. In *Hindcastle*, the House of Lords concluded that such a distinction makes neither "legal [n]or commercial sense."[28] The House of Lords in *Hindcastle* overruled *Stacey v. Hill*, and the Court in *Crystalline* concluded that *Cummer-Yonge* should "meet the same fate."[29] Specifically, the Court said, "post-disclaimer, assignors and guarantors ought to be treated the same with respect to liability. The disclaimer alone should not relieve either from their contractual obligations."[30]

III. THE EFFECT OF THE *CRYSTALLINE* DECISION

A. An Overview of Pertinent Sections of the Bankruptcy and Insolvency Act

Canadian federal law provides some protections both for a person who has declared bankruptcy and for a person who is not legally bankrupt but who is insolvent under the provisions of the Bankruptcy and Insolvency Act.[31] Under the BIA, a person is insolvent if he is not bankrupt but "is for any reason unable to meet his obligations as they generally become due" or who has "ceased paying his current obligations in the ordinary course of business as they generally become due."[32] The process requires the party to file a proposal on what steps it should take to remain viable, including the disposition of contractual obligations.[33] Among other options, a party may assign any commercial leases to a trustee, and the trustee who has been assigned a lease under the Act can disclaim or repudiate the lease.[34]

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27. *Id.* ¶ 39, quoting from J.W. Lem & S.T. Proniuk, *Goodbye* 'Cummer-Yonge'*: A Review of Modern Developments in the Law Relating to the Liability of Guarantors of Bankrupt Tenants*, 1 D.R.P.L. 419 at 436 (1993).
28. Hindcastle Ltd. v. Barbara Attenborough Assocs. Ltd., [1997] A.C. 70, 95 (H.L.).
29. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 42.
30. *Id.*
31. Bankruptcy and Insolvency Act (BIA), R.S.C., ch. B-3, § 65.2(1) (1985) (Can.), "Insolvent person may disclaim commercial lease"; Bankruptcy and Insolvency Act, R.S.C., ch. B-3, § 65.21 (1985) (Can.), "Lease disclaimer where tenant is bankrupt."
32. R.S.C., ch. B-3, § 2(1) (1985) (Can.). The definition of "insolvent person" also includes a person "the aggregate of whose property is not, at a fair valuation, sufficient or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due." An insolvent person either "resides, carries on business or has property in Canada" and has liabilities to creditors "provable as claims under this Act" which amount to one thousand dollars.
33. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60 ¶ 28.
34. R.S.C., ch. B-3, § 65.2(1) (1985) (Can.).

A commercial lease may be disclaimed[35] by a tenant who is bankrupt[36] or is insolvent and has made a proposal under the BIA.[37] The tenant must give thirty days notice to the landlord in the manner prescribed by the Act. The landlord may challenge the disclaimer in court on the grounds that section 65.2(1) does not apply, and the court has the discretion to make a declaration to that effect.[38] The court must grant the declaration unless the tenant debtor can satisfy the court that the granting of the declaration would jeopardize the tenant's ability to make a viable proposal to its creditors.[39] Under the Act, where the lease has been disclaimed, the landlord has no claim for accelerated rent for the remaining rent due on the rest of the lease, despite any language to the contrary in the lease.[40] Instead, the landlord is entitled to exactly six month's rent: three months in arrears rent and three months in accelerated rent.[41]

Provincial legislatures also have landlord-tenant law or bankruptcy protection addressing the issue of tenant's rights in bankruptcy or insolvency. The provinces may pass laws regulating bankruptcy and insolvency in that province and may regulate the rights of landlords and tenants, including during and after insolvency or bankruptcy; provincial laws may overlap with federal laws, but if the two laws expressly conflict or contradict each other, the federal law prevails.[42]

B. THE STATE OF THE LAW BEFORE *CRYSTALLINE*

In 1965, the Ontario Supreme Court handed down a decision in *Cummer-Yonge v. Fagot*, later affirmed by the Ontario Court of Appeals,[43] which dealt with the right of a landlord against guarantors of a commercial lease after the trustee of the bankrupt tenant disclaimed the lease.[44] The tenant in that case made a voluntary assignment in bankruptcy, and the trustee in bankruptcy disclaimed the lease.[45] The tenant had two guarantors on the lease from which the landlord sought to collect the rent due.

35. The original BIA § 65.2 used the term "repudiate" but was amended in 1997 to say "disclaim." An argument was made that the change in language indicated the terms should be construed differently, but the Court of Appeals in *Crystalline* rejected that argument. *Crystalline Invs., Ltd.*, [2001] 31 C.B.R. (4th) 216, ¶ 9. The Supreme Court did not disturb the Court of Appeals's construction. *Crystalline Invs., Ltd.*, [2004] S.C.R. 60.
36. R.S.C., ch. B-3, § 65.21 (1985) (Can.).
37. R.S.C., ch. B-3, § 65.2.
38. R.S.C., ch. B-3, § 65.2(2).
39. Jay A. Carfagnini & Amy Vanderwal, *Landlord Issues in Insolvencies—Ontario*, INSOLVENCY INSTITUTE OF CANADA (Sept. 2003).
40. Bankruptcy and Insolvency Act, R.S.C., ch. B-3, § 65.2(4) (1985) (Can.). "Where a lease is disclaimed under subsection (1), (a) the landlord has no claim for accelerated rent."
41. Brian G. Clark & Jeffrey W. Lem, *Ding Dong the Witch is Dead*, BUILDING, Feb./Mar. 2004, at 17 [hereinafter *Ding Dong the Witch is Dead*].
42. Multiple Access Ltd. v. McCutcheon, [1982] 2 S.C.R. 161, ¶ 8 (Can.).
43. Cummer-Yonge Invs. Ltd. v. Fagot, [1965] 2 O.R. 157n (Ont. C.A.).
44. Cummer-Yonge Invs. Ltd. v. Fagot, [1965] 2 O.R. 152 (Ont. H.C.).
45. *Id.* ¶ 3.

The guarantors claimed that they were not liable to the landlord for rent despite a contractual agreement in the lease in which they guaranteed performance on the rent.[46] The court agreed and held that when the tenant assigned its interest to a trustee under the Act, the tenant no longer had any property interest in the lease, and the tenant's obligations under the lease were terminated.[47] Because the guarantor's obligation is to guarantee performance of the tenant's obligations under the lease,[48] after assignment under the BIA the landlord could not enforce any obligation under the lease against the guarantor, because, the court said, there was nothing left to guarantee.[49] Landlords were considered by the court as "preferred creditors," ranking before unsecured creditors but after secured creditors, and entitled to only three months in back rent and three months accelerated rent.[50]

In the forty years after *Cummer-Yonge*, landlords devised various legal tactics to get around the ruling and to protect themselves from the possibility of an insolvent tenant.[51] One tactic was to require an indemnity agreement rather than a guarantee. The court in *Cummer-Yonge* had classified the landlord's claim as "secondary"; using an indemnity agreement became a way to give the landlord a "primary debt."[52] Other landlords relied on letters of credit, which are considered "autonomous obligations" that are "independent and primary" and effective whether the tenant is bankrupt or not.[53] As of the time of the *Crystalline* decision, landlords rarely relied on a surety signing a "guarantee."[54]

But these methods were far from certain; various provincial courts in the last decade concluded that disclaiming a lease under the BIA relieved other third parties from their obligations as well. For example, the British Columbia Court of Appeals in *West Shore Ventures Ltd. v. K.P.N. Holdings, Ltd.* found that under the terms of the lease in question, the landlord could not draw on a letter of credit that had been used as surety by the tenant because after the trustee disclaimed the lease and vacated the premises, there were no longer any obligations left for the letter of credit to secure.[55] But the court left more uncertainty for drafters and landlords by stating that its holding was limited to the facts of the case, and a differently drafted lease might have created obligations that survived the bank-

46. *Id.* ¶ 6.
47. *Id.* ¶ 8.
48. Clark & Lem, *supra* note 17.
49. *Id.*
50. *Id.*
51. Brian G. Clark & Jeffrey W. Lem, Cummer-Yonge *Can Overcome*, BUILDING, June/July 2003, at 26. "Cummer-Yonge is arguably an avoidable problem (the courts have said so) but it requires a great deal of understanding of how the law really works and the patience to draft carefully."
52. Carfagin, Herlin & Bell, *supra* note 2, at 1.
53. *Id.*
54. Brian G. Clark & Jeffrey W. Lem, *That Lease and a Quarter Will Get You a Cup of Coffee*, BUILDING, Apr./May 2003, at 21.
55. West Shore Ventures Ltd. v. K.P.N. Holdings Ltd., [2001] 39 R.P.R.3d 155 (B.C.C.A.), ¶ 38, *leave to appeal to S.C.C. denied*, 2001 CarswellBC 2074.

ruptcy which would keep good the letter of credit.[56] There was also some variation in courts' application of *Cummer-Yonge* as to the date after which landlords could not seek protection from third parties. Some held that the date of the disclaimer determined when the landlord's rights against the guarantors were terminated, but others based it on the date of the assignment.[57] As a result, the case law did not give any degree of certainty as to "the effect of the bankruptcy on 'third parties' who have indicated that they will provide some measure of protection for the landlord with respect to the commercial tenant's obligations."[58]

C. THE *CRYSTALLINE* DECISION AND THE LAW TODAY

The Court's decision in *Crystalline* is one of the most significant landlord-tenant law cases of the last three decades.[59] Although the *Crystalline* court's statements regarding *Cummer-Yonge* were dicta, a lower court would likely feel bound to follow the SCC on this issue.[60] Some commentators worry that the *Crystalline* decision, rather than ending the rule of *Cummer-Yonge*, has just created more uncertainty.[61] The decision may still not prevent a landlord from losing benefits under a guarantee or indemnity when the lease is disclaimed by the original tenant under a bankruptcy or proposal under the BIA.[62] Drafters of leases may need to take care to provide for the possibility that courts will not apply *Crystalline* outside of the context of assignor/assignee situations,[63] or it may be that there is no longer a need to draft around *Cummer-Yonge*.[64] Hopefully, the Court's language in *Crystalline* will lead lower courts to focus on the actual language of the guarantee or assignment clause in the lease to consider what the parties actually agreed to.[65]

Few courts have considered the issue since the Court handed down its decision in January of 2004, so no one knows how broadly the decision will be applied. Some commentators question the existence of uncer-

56. *Id.* ¶ 41.
57. Jeffrey C. Cahart, Cummer-Yonge *Revisited: The Effect of the Bankruptcy of a Commercial Tenant on Guarantees, Indemnity Agreements and Letters of Credit Pertaining to the Lease Obligations*, 19 C.B.R.3d 170, ¶ 25.
58. *Id.* ¶ 3.
59. Jeffrey W. Lem & Brian Clark, Annotation, Crystalline Invs., Inc. v. Domgroup Ltd., [2004] S.C.R. 60. "At the risk of hyperbole, these annotators submit that the decision of the Supreme Court of Canada in *Crystalline Investments Ltd v. Domgroup Ltd.* is, bar none, the single most important Canadian landlord and tenant law decision since [1971]."
60. Carfagin, Herlin & Bell, *supra* note 2, at 2.
61. *Ding Dong the Witch is Dead* , *supra* note 41.
62. *Goodbye* Cummer-Yonge, FOCUS ON FINANCIAL SERVICES (Fraser Milner Casgrain LLP), Mar. 2004, http://www.fmc-law.com/userfiles/page_attachments/Library/2/ 2966660FocusonFinancialServicesMarch2004IssueNo.63.pdf.
63. John Payne, *Letters of Credit, Leases and Bankruptcy*, REAL ESTATE BRIEF (Lang Michener, LLP, Toronto), July 2004, *available at* http://www.langmichener.com/?act=pub& act2=dis&pub=333.
64. David N. Ross, *Clarifying Canadian Landlords' Rights*, COUNSEL TO COUNSEL, May 2004, at 20, *available at* http://martindale.com/pdf/c2c/magazine/2004May/C2CMay04 Horizon.pdf.
65. Carfagin, Herlin & Bell, *supra* note 2.

tainty under *Cummer-Yonge* and doubt the wisdom of completely overruling the *Cummer-Yonge* principle as applied to guarantors.[66] *Crystalline* will no doubt be influential, if not actually determinative, in cases dealing with other third party sureties.[67] One commentator speculated that the scope of the holding "will presumably" be "extended to indemnifiers and to payees under letters of credit."[68] Then in June of 2004, in *KKBL No. 297 Ventures Ltd. v. IKON Office Solutions Inc.*, (*KKBL*), the British Colombia Court of Appeals did just that and applied the holding of *Crystalline* to the indemnifier of a commercial lease.

In *KKBL*, the original tenant assigned its lease to a new tenant and, as a condition to being released from its obligations under its lease, agreed to act as an indemnifier for the new tenant.[69] The case involved the original tenant, rather than the original tenant's assignee as in *Crystalline*, but Hall, J.A., found that "the reasoning of . . . *Crystalline* is equally applicable in both situations."[70] Following the analysis[71] in *Crystalline* and *Hindcastle*, the court held that a proposal filed under the BIA benefits only the insolvent tenant, so third parties are not automatically relieved of their obligations to the landlord. As a consequence, the lower court's ruling, based on the same logic of *Cummer-Yonge*, could not stand as decided.[72] Though the full extent of *Crystalline's* effect is unclear, what is clear is that, like the lower court's decision in *KKBL*, most cases in which the court relied on the reasoning in *Cummer-Yonge* to reach an outcome cannot still be considered good law.[73]

IV. CONCLUSION

Crystalline has the potential for widespread, significant effects on landlord-tenant law and on the responsibility of third party sureties of commercial leases. Tactics used by contract drafters to get around the *Cummer-Yonge* result and ensure landlord protection may no longer be necessary, though of course careful drafters should always be diligent in providing adequate protection for clients. The BIA, under the interpretation of Canada's highest court, does not directly benefit third party sureties. The Supreme Court of Canada will not differentiate between a guarantor (and presumably other third party sureties) and an assignor after the disclaimer of a commercial lease under the BIA. The Court has signaled that it will not uphold decisions based on the *Cummer-Yonge*

66. Candice Arnold, Comment, Crystalline Invs. Ltd. v. Domgroup Ltd., 19 N.C.D. REV. 10.
67. *Id.*
68. Goodman & Carr LLP Commercial Leasing Group, *Victory for Landlords at the Supreme Court*, G&C CLIENT ADVISORY (Goodman & Carr LLP, Toronto), http://www. goodmancarr.com/pdfs/2004_03_leasing_advisory.pdf (March 2004).
69. KKBL No. 297 Ventures Ltd. v. IKON Office Solutions Inc., [2004] BCCA 468, 3.
70. *Id.* at 20.
71. *Id.* at 27.
72. *Id.* at 27.
73. Jeffrey W. Lem, Annotation, KKBL No. 297 Ventures Ltd. v. IKON Office Solutions Inc., [2004] 21 B.C.L.R.4th 163.

line of reasoning. Whether for the better or worse, the landscape of landlord-tenant law with respect to bankruptcy and insolvency has changed dramatically.