

Tenant bankruptcy and beyond – Spring 2008

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“Bankruptcy” is commonly used to describe a number of legal situations involving a tenant’s financial distress. But with the rights and obligations of landlords and tenants determined by the true course of action taken, it pays for both sides to get the facts.

It’s a common situation. A tenant is in financial distress and a number of terms receiver, trustee, bankruptcy get bantered about, with questions about legal obligations cropping up. Can the landlord terminate the lease or collect rent arrears? Is the tenant still responsible for making rent payments? Can the tenant assign or repudiate the lease?

While the term “bankrupt” is often used generically to describe a number of legal situations involving a tenant, the rights and obligations of landlords and tenants are anything but generic in each situation. Here’s how different courses of action in dealing with a tenant’s financial difficulties can affect the rights and obligations of each party.

Privately appointed receiver

If a tenant defaults on a loan or security agreement, a secured creditor may have the option of appointing a receiver based on the terms of the loan or security agreement. In general, the receiver steps into the shoes of the tenant and is subject to the same obligations. If the receiver takes possession of the leased premises, it is responsible for paying rent and has no greater rights than the tenant under the lease. Unless a landlord has signed an agreement giving special rights to the privately appointed receiver, they maintain all rights and obligations set out in the lease.

Court appointed receiver

If a court appoints a receiver, the court order will set out the receiver’s powers. Typically, the receiver takes control of the tenant’s assets and the landlord is prohibited from terminating the lease or interfering with the receiver’s right to possession of the premises without a court order. The receiver must pay rent at the rate set out in the lease, and the court order may allow the receiver to assign or abandon the lease. The landlord is generally prohibited from seizing goods to cover rent arrears without obtaining a court order.

Interim receiver under the *Bankruptcy and Insolvency Act* (“BIA”)

To preserve a tenant’s assets after they have filed for bankruptcy, a court will appoint an interim receiver before the petition for bankruptcy is actually heard. Usually, the interim receiver acts as a monitor and the tenant continues to operate its business. The tenant must continue paying rent and comply with the terms of the lease.

However, the landlord will likely be prohibited from terminating the lease or otherwise exercising its remedies, including the right to seize assets for non-payment of rent, unless it first obtains a court order.

Trustee in bankruptcy

When a tenant's bankruptcy petition is successful and a bankruptcy order is issued, the trustee's role is to help in the orderly administration of the estate. The trustee has the right to occupy the leased premises (and must continue paying rent) for three months after the tenant's bankruptcy and can choose to retain, disclaim or in some circumstances assign the lease. The trustee's conduct is not governed by the terms of the lease as the trustee is entitled to take whatever steps are necessary for the orderly administration of the estate. The landlord cannot terminate the lease during this three-month period or seize a tenant's assets. Once a bankruptcy order is issued, however, the landlord has a preferred claim for 3 months arrears and 3 months accelerated rent.

BIA proposal

The BIA provides a system under which a tenant can restructure its business, make a deal with creditors to accept a percentage of the debts owing to them and continue in business. While the tenant is restructuring, a landlord can't interfere with the tenant's occupancy of the premises, take any steps to collect arrears, or terminate the lease without an order from the court. However, the tenant must continue to pay rent and is required to comply with the terms of the lease. At any time between the filing of the notice of proposal and the filing of the proposal itself, a tenant can disclaim the lease by giving the landlord 30 days' notice. The BIA contains a procedure allowing the landlord to challenge the disclaimer.

CCCA Proposal

Under the *Companies Creditors Arrangement Act*, a tenant can also restructure and continue in business based on a court order, with rights and obligations similar to a BIA proposal. The court order frequently requires tenants to comply with the terms of use contained in the lease. The landlord cannot take steps to collect arrears, but arrears payments are usually dealt with as part of the proposal to creditors. Court orders frequently allow the tenant to abandon, disclaim or assign the lease, and provide that any resulting damages to the landlord be dealt with in the proposal.

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