CITATION: TNG Acquisition Inc. (Re) , 2011 ONCA 535
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COURT OF APPEAL FOR ONTARIO

Laskin, Goudge and Gillese JJ.A.

In the Matter of the Bankruptcy of TNG Acquisition Inc., (successor estate of NexInnovations Inc., a bankrupt) of the City of Mississauga, in the Province of Ontario

Kenneth D. Kraft, for the appellant (Hewlett-Packard (Canada) Co., formerly EDS Canada Inc.)

David S. Ward, for the trustee-in-bankruptcy (A. Farber & Partners Inc.)

Heard: May 31, 2011

On appeal from the judgment of Justice Colin L. Campbell of the Superior Court of Justice, dated November 5, 2010.

Gillese J.A.:

[1] What is the legal effect of a notice of repudiation of lease given during *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (*CCAA*) proceedings? This appeal answers that question.

THE FACTS

[2] EDS Canada Corp. (EDS or the Landlord) was the sublessor of premises located in Mississauga, Ontario. In June 2001, EDS subleased the premises to NexInnovations (Nex).

[3] On October 2, 2007, Nex obtained creditor protection under the *CCAA* (the Initial Order).

[4] Para. 8 of the Initial Order made in the *CCAA* proceedings gave Nex the right to repudiate leases. The relevant part of para. 8 reads as follows:

> 8. **THIS COURT ORDERS** that *the Applicant shall have the right*, but not the obligation, *to*:
>
> …
>
> (c) vacate, abandon or quit any leased premises and/or terminate or *repudiate any lease*, license and any ancillary agreements relating to any leased or licensed premises, without prior notice (or such other notice period agreed to by the relevant landlord and the Applicant) in writing, delivered by fax or courier to the last known address of the relevant landlord, *on such terms as may be agreed upon between the Applicant and such landlord or, failing such agreement, to deal with the consequences thereof in the Plan*; [emphasis added]

[5] The Initial Order also appointed Prowis Inc. as Chief Restructuring Officer (CRO) for Nex.

[6] The CRO sent EDS a letter dated February 22, 2008, on behalf of Nex, stating that, among other things, Nex was repudiating the lease, effective March 21, 2008 (the Repudiation Letter).

[7] The Repudiation Letter included an acknowledgment to be signed and dated by EDS and returned to Nex. EDS never acknowledged, accepted or returned the Repudiation Letter to Nex.

[8] Nex abandoned the premises effective March 21, 2008.

[9] EDS immediately attempted to find a new tenant to re-let the premises but was unsuccessful.

[10] Nex's restructuring efforts failed. It never filed a plan of arrangement.

[11] The majority of Nex's assets was sold pursuant to orders made in the *CCAA* proceedings. Following the sale, one of the purchasers occupied a portion of the premises and paid occupation rent for the period from March 22, 2008, to July 22, 2008, in the approximate amount of $136,260.00.

[12] On April 8, 2008, Nex was declared bankrupt (the Nex Bankruptcy Order).

[13] On August 21, 2008, EDS submitted a proof of claim to A. Farber & Partners Inc. (the Trustee), in its capacity as trustee in bankruptcy of TNG Services Inc., (formerly known as Nex), for its "unrecoverable expenses" during the entire term of the lease up to January 30, 2012. The claim was for $3,313,500.24 (the Claim).

[14] On September 18, 2008, the Trustee issued a disclaimer of the lease. A trustee's disclaimer of a lease brings the lease to an end and terminates all rights and obligations for the payment of rent. Thus, if the trustee disclaims the lease, the landlord has no claim for rent for the remainder of the lease.

[15] On December 29, 2008, the Trustee obtained a sale approval and vesting order which, among other things, annulled the Nex Bankruptcy Order. The same order transferred all Nex assets to TNG Acquisition Inc. (TNG).

[16] TNG was then adjudged a bankrupt. All claims formerly against Nex became claims against TNG and all Nex assets became available to satisfy such claims.

[17] On October 13, 2009, the Trustee disallowed the bulk of the Claim.[1]

[18] Hewlett-Packard (Canada) Co. (HP) is the successor to EDS. HP moved to have the disallowance set aside and the Claim declared to be valid.

[19] Justice Colin Campbell heard and dismissed the motion.

[20] HP appeals. For the reasons that follow, I would dismiss the appeal.

THE JUDGMENT BELOW

[21] The motion judge found that the facts were not in dispute and that a single issue had to be decided: what effect was to be given to the Repudiation Letter in the context of

[1] It allowed a preferred claim for 18 days of unpaid rent from March 22 to April 8, 2008, and a preferred claim for three months accelerated rent following the date of the Nex Bankruptcy Order, limited to the value of Nex's assets that were on the premises at the date of the bankruptcy. After the sale of the Nex assets, the preferred claim was allowed at $7,775. The Trustee also allowed an unsecured claim for a portion of the arrears, operating costs and the cost of repairs to the HVAC system on the premises.

a *CCAA* proceeding? He noted that the issue may now be dealt with by amendments to the *CCAA* as of September 2009.[2]

[22] The Landlord took the position before the motion judge that repudiation of the lease was complete when it received the Repudiation Letter. Thus, it submitted, the Trustee could not disallow the Claim following bankruptcy because the lease had been forfeited before bankruptcy.

[23] The Trustee's position was that the CRO could not unilaterally repudiate the lease, since repudiation does not in and of itself bring an end to the lease. It merely confers on the innocent party a right of election to treat the lease as at an end, thereby relieving the parties of further performance, though not relieving the repudiating party from its liabilities for breach.

[24] The motion judge noted that the Landlord had accepted the continuance of rent payments without objection, both before and after the Repudiation Letter.

[25] He then considered this court's decision in *Place Concorde East Ltd. Partnership v. Shelter Corp. of Canada Ltd.* (2006), 270 D.L.R. (4th) 181, in which rescission and repudiation were distinguished. Rescission is a remedy available to an innocent party when the other party has made a false or misleading representation. It allows the innocent party to treat the contract as void *ab initio*. In contrast, repudiation occurs by

[2] Based on the factums of both parties, it appears that the motion judge was referring to s. 32 of the *CCAA*. Section 32 was originally added to the *CCAA* by S.C. 2005, c. 47, s. 131; it came into force on September 18, 2009. Prior to coming into force, s. 32 was amended by S.C. 2007, c. 29, s. 108, effective June 22, 2007, and c. 36, effective December 14, 2007.

words or conduct that show an intention not to be bound by the contract. The consequences of repudiation depend on the election made by the innocent party. The innocent party can elect to treat the contract as remaining in full force and effect. In that case, both parties have the right to sue for damages for past or future breaches. Alternatively, the innocent party can elect to accept the repudiation and the contract is terminated. Each party is then discharged from future obligations.

[26] The motion judge observed, based on *Highway Properties v. Kelly, Douglas & Co.*, [1971] S.C.R. 562, that the same principle applies in the case of repudiation of commercial leases. He said it was particularly important in *CCAA* proceedings for the landlord to promptly advise which option it intends to pursue, when it receives notice of repudiation from a commercial tenant.

[27] Based on the authorities, the motion judge was satisfied that the lease had not been forfeited prior to bankruptcy. While the tenant had given notice of repudiation, the Landlord had not responded to the notice prior to bankruptcy. Accordingly, the Trustee was entitled to disallow the Claim on the basis of disclaimer under s. 30(1)(k) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (*BIA*).

THE ISSUES

[28] HP raises two issues on appeal:

1. Did the Trustee have anything left to disclaim or was the Claim crystallized as an unsecured damages claim as at the date of bankruptcy?

2. Did the motion judge err in holding that more was required of the landlord in the context of the Repudiation Letter sent to EDS in the course of a *CCAA* proceeding?

ISSUE #1 Did the Trustee have anything left to disclaim at the date of bankruptcy?

[29] HP submits that, in the *CCAA* context, the Repudiation Letter had the effect of ending the lease. Thus, as of March 21, 2008 – the date stipulated in the Repudiation Letter and prior to the bankruptcy – Nex no longer had any interest in the premises. HP says that pursuant to the terms of the Initial Order, it (as successor in interest to EDS) could not take any steps in respect of the repudiation of the lease other than to file a damages claim at the appropriate time. The fact that Nex ended up a bankrupt and did not file a plan of compromise or arrangement in respect of the *CCAA* proceedings could not undo the legal relationship that existed as at the date of bankruptcy. Accordingly, HP contends, at the date of the Nex bankruptcy, there was no longer a landlord/tenant relationship between EDS and Nex. Rather, it was simply a debtor/creditor relationship. Therefore, at the date of bankruptcy, there was no lease left for the Trustee to disclaim and it (HP) had an unsecured damages claim.

[30] I do not accept this submission.

[31] I begin by observing that on the facts of this case, it is hard to see how this submission could succeed, given that EDS accepted rent payments after receipt of the Repudiation Letter. But – more importantly – I reject the submission because it

essentially asks the court to find that repudiation and termination are one and the same thing in a *CCAA* proceeding. They are not. Repudiation and termination are legally distinct acts that lead to significantly different legal rights and obligations for the parties. They are not to be conflated.

[32] As the motion judge observed, *Highway Properties* is the seminal Canadian case on repudiation of commercial leases. In *Highway Properties*, a major tenant in a shopping centre repudiated its lease. The landlord resumed possession and notified the tenant that it would be held liable for damages it (the landlord) suffered as a result of the repudiation. The landlord sued for damages not only for the losses suffered to the date of repudiation but also for prospective losses resulting from the tenant's failure to carry on business in the shopping centre for the full term of the lease. At trial and on appeal, the courts held that the landlord could recover only for breaches that occurred to the date of surrender. On further appeal to the Supreme Court, Laskin J., writing for a unanimous court, allowed the appeal and awarded damages as the landlord had sought.

[33] At p. 570 of *Highway Properties*, Laskin J. set out three courses of action that a landlord may take when a tenant has repudiated the lease entirely: 1) the landlord may insist on performance and sue for rent or damages on the footing that the lease remains in force; 2) the landlord may elect to terminate the lease, retaining the right to sue for rent accrued due or for damages to the date of termination for previous breaches of covenant; or 3) the landlord may advise the tenant that it proposes to re-let the property on the tenant's account and enter into possession on that basis.

[34] Thus, as *Highway Properties* makes clear, termination and repudiation are distinct legal concepts. To terminate a lease is to bring it to an end. Repudiation of a lease, on the other hand, does not in itself bring the lease to an end. Repudiation occurs when one party indicates, by words or conduct, that they no longer intend to honour their obligations when they fall due in the future. It confers on the innocent party a right of election to, among other things, treat the lease as at an end, thereby relieving the parties of further performance, though not relieving the repudiating party from its liabilities for breach.

[35] One party to a lease cannot unilaterally end its obligations under the lease. In the absence of proof of both acceptance of the repudiation and notification of the acceptance, the lease will be treated as subsisting. See *Williams v. Good Call Productions Ltd.* (2003), 35 B.L.R. 249 (Ont. Sup. Ct.), at para. 28, quoting Asquith L.J.in *Howard v. Pickford Tool Co.*, [1951] 1 K.B. 417, at 421 (Eng. C.A.):

> An unaccepted repudiation is a thing writ in water and of no value to anybody; it confers no legal rights of any sort or kind. Therefore a declaration that the defendants had repudiated their contract with the plaintiff would be entirely valueless to the plaintiff if it appeared at the same time, as it must appear in this case, that it was not accepted.

[36] Due to the nature of the rights that a landlord has when a tenant repudiates a lease, I agree with the motion judge when he states that it is particularly important in *CCAA* proceedings for the landlord to promptly advise the tenant which option it intends to pursue.

[37] In the present case, EDS never made an election after receiving the Repudiation Letter. It did not acknowledge or accept the repudiation. Moreover, neither of the two alternative mechanisms provided by para. 8(c) of the Initial Order for dealing with repudiation was used. It will be recalled that para. 8(c) gave the tenant the right to repudiate "on such terms as may be agreed upon" between it and EDS and Nex or, "failing such agreement, to deal with the consequences thereof in the Plan". There was no such agreement between the parties nor was a plan of arrangement or compromise ever filed in the *CCAA* proceeding.

[38] Accordingly, notwithstanding the Repudiation Letter, the relationship between EDS and Nex remained that of landlord and tenant at the date of the bankruptcy. Thus, in my view, the motion judge correctly concluded that the lease had not been brought to an end in the *CCAA* proceedings and it was, therefore, susceptible to statutory disclaimer by the Trustee following the commencement of bankruptcy.

ISSUE #2 Was the landlord required to do something in order to make the repudiation notice effective?

[39] HP submits that the motion judge erred in holding that the landlord was required to do something in order to make the repudiation effective. It argues that in the context of a *CCAA* proceeding, it makes no sense for a landlord to do anything other than accept the notice of repudiation, locate a new tenant and file a damages claim.

[40] For the reasons given above, I would not accept this submission. The caselaw makes it clear that the landlord has an election to make when a tenant repudiates. The landlord must make the election in order for the parties to know what consequences flow from the repudiation. If the landlord does nothing, the landlord/tenant relationship remains and the lease continues in force: *Highway Properties*, at p. 570.

DISPOSITION

[41] Accordingly, I would dismiss the appeal with costs to the respondent in the agreed on sum of $2,500, all inclusive.

RELEASED: JUL 28 2011 ("E.E.G.")

"E.E. Gillese J.A."
"I agree. J.I. Laskin J.A."
"I agree. S.T. Goudge J.A."