

INSOLVENCY & COMMERCIAL LEASING
IN THE COVID ERA
PRESENTATION TO UDI
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Claire has a broad civil litigation practice with a focus on real estate litigation. She is a member of our Commercial Litigation, Insurance, Commercial Real Estate and Professional Liability Groups.

She delivers focused results based on an in-depth understanding of her clients' business needs. She is also passionate about Vancouver business and community interests, and chairs the firm's Diversity and Inclusion Committee.

Claire represents commercial and residential landlords and property managers, real estate owners and developers, corporate stakeholders, and a wide variety of regulated professionals. She regularly appears in British Columbia Supreme Court, the British Columbia Court of Appeal, and a variety of regulatory bodies and administrative tribunals, and has assisted clients before the Supreme Court of Canada.

Background:

- As we all know, COVID (and other economic factors) are having significant impact on a variety of commercial sectors
- Retail, restaurant, and personal service businesses are suffering the most acutely, and many may face insolvency in the coming months (and are currently technically insolvent)
- Landlords in these sectors are facing serious issues as tenants face insolvency
- In court-supervised insolvency and re-structuring process, rent arrears will be placed into a priority sequence with other unsecured creditors and are not overly likely to be re-paid if secured creditors and tax and pay-roll obligations make up much of the available funds

Commercial Tenancy Remedies Pre-COVID

- Pre-COVID, commercial landlords had a number of options when a tenant didn't pay rent that include:
 - Affirm the lease and sue for arrears
 - Terminate the lease and sue for arrears (eviction)
 - Distraint (seizure of goods and property from leased premises to secure unpaid rent)

CECRA and Commercial Tenancy Remedies – BC Considerations

- Ministerial Order M179: May 29, 2020
 - Commercial landlords eligible for Canada Emergency Commercial Rent Assistance (CECRA) but who refuse to enter into a rent reduction agreement that includes an eviction moratorium will not be able to evict defaulting tenants, nor will they be able to distrain defaulting tenants' possessions against unpaid rent
 - The order will expire on the earlier of the end of the state of emergency or the last date assistance under CECRA is available

CECRA and Commercial Tenancy Remedies

- Remedies available to CECRA-eligible landlords are limited by M179 during CECRA and the state of emergency
- However, CECRA is currently scheduled to provide assistance for April, May, June, July, and August only
- The duration of the state of emergency is difficult to predict, and will eventually expire

CECRA and Commercial Tenancy Remedies

- It is not clear at this time if the government will provide further assistance to small businesses with respect to commercial rent after the end of CECRA, or if CECRA will be extended
- However, at some time in the future, landlords and tenants in CECRA-eligible leases should anticipate that unpaid rent or some amount of it will be due and owing and landlords will be able to take steps to collect, including through terminating leases and distraint
- Landlords and tenants in non-CECRA eligible leases are already facing these issues

Rent Deferral Agreements

- Some landlords are entering into rent deferral agreements with non-CECRA eligible tenants, agreeing to payment schedules over periods of time (6 months-1 year are common timelines)
- Rent deferral agreements have the benefit of easing immediate financial strain on struggling businesses; however, tenants and landlords should carefully consider if the tenant will be able to meet its regular financial obligations in the near future together with repayment of deferred rent
- Landlords should consider asking tenants to pay their triple net expenses (e.g., proportional share of property taxes and maintenance) to be sure landlords are not out of pocket immediately

Unpaid Rent and Insolvency

- It is reasonable to expect that some tenants who cannot pay their rent now may not be able to pay rent plus unpaid deferred or owing rent in the upcoming months
- These tenants are at high risk of insolvency and should be considering their options under the CCAA or the BIA

Unpaid Rent and Insolvency

- It is not likely that unsecured unpaid rent will be high in the priority debts in an insolvency process; the CRA and secured lenders rank higher than landlords, and those debts (together with other preferred debts such as money owed to employees) may make up most of the estate of the insolvent company
- Moreover, many tenants will be single-use entities without significant assets, even if the business is managed by a corporate parent

Insolvency Proceedings: Plans & Proposals to Avoid Insolvency

- Tenants facing insolvency can file a plan under the *Companies' Creditors Arrangement Act* (CCAA) or a proposal under the *Bankruptcy and Insolvency Act* (BIA) for protection from creditors.
- The plans or proposals are intended to find a way for the tenant to avoid receivership or bankruptcy.
- If a tenant files a plan under the CCAA or a proposal the BIA, there is a stay of proceedings and creditors may not begin or continue any legal action.

Insolvency Proceedings & Disclaiming Leases

- Under both BIA proposal proceedings and CCAA plan proceedings, a tenant may disclaim a lease by giving 30 days' notice to the landlord.
- Under the CCAA, the tenant must also obtain either (1) approval from the Monitor appointed under the CCAA; or (2) a court order approving of the disclaimer.
- Under both types of proceedings, the landlord can make an application to the court opposing the disclaimer.
- If the disclaimer is opposed, the tenant must satisfy the court that the insolvent tenant would not otherwise be able to make a viable proposal (BIA) or plan (CCAA).

Insolvency Proceedings & Quantifying Claims

- Under a BIA proposal, the landlord's claim will be the lesser of:
 - (i) the aggregate of the rent for the first year following the date on which the disclaimer became effective and 15 per cent of the rent for the remainder of the term of the lease after that year;
or
 - (ii) three years' rent.
- Under a CCAA plan, there is no statutory formula for the quantification of a landlord's claim, and the landlord will have a claim for unsecured damages.

Bankruptcy Proceedings

- Bankruptcy proceedings are governed by the BIA.
- In a bankruptcy proceeding, a landlord is granted a preferred claim for three months of rent arrears and up to three months of accelerated rent if permitted by the lease.
- However, rent deferral agreements may affect the landlord's preference: if rent has been deferred, arguably it is not "currently owing" at the time of the bankruptcy, meaning that the landlord may not get the benefit of any preference.
- The preference may be preserved, in some cases, where the deferral arrangement was structured as a forbearance.

COVID-19 Case Law

- Some recent commercial disputes have discussed the changed market conditions arising from COVID-19
- For example, in a foreclosure proceeding from early June 2020, the court accepted evidence from leasing agents that there had been a significant slowdown in the overall retail leasing market in Vancouver within the last three months. ([Institutional Mortgage Capital Canada Inc. v. Plaza 500 Hotels Ltd.](#), 2020 BCSC 888 (June 12, 2020))
- In that case, however, the court found that COVID-19 had "simply further exposed the weaknesses of the property" and was not itself a cause of them, so the pandemic's effects ultimately had no bearing on the outcome of the proceeding.
- The Court of Appeal subsequently found that the Supreme Court was entitled to take judicial notice of the effects of COVID-19 on business operations

COVID-19 Case Law

- In a proceeding under the *Companies' Creditors Arrangement Act* (CCAA) that was heard in mid-June, a university brought an application for rent deferral regarding its lease of student residences. ([Quest University Canada \(Re\)](#), 2020 BCSC 921 (June 19, 2020))
- The university was in the midst of restructuring under the CCAA.
- The court notes that while the university cleared out its residences as a result of COVID-19, the pandemic did not materially alter the use of the residences over the summer, which had historically been used at similar rates at that time of year.
- Accordingly, the court found that the university continued to use the leased residences in the way the parties intended.
- Therefore, allowing the deferral would amount to imposing different terms of payment on the landlord, which was not appropriate.
- The university's application for court-ordered rent deferral was dismissed.

Options for Landlords

- Commercial landlords concerned about a tenant's imminent insolvency have several options:
 - Request outside security (for example, a personal guarantee or a GSA from another corporate entity) in a rent deferral agreement
 - Consider distraint if the tenant has significant saleable goods

Further Considerations

- Landlords should review their leases to be clear on which corporate entity is the tenant and to be clear about whether there are any personal or corporate guarantors of the lease; those guarantors may not be protected in an insolvency process
- Tenants seeking to re-organize rather than liquidate should consider whether their goods are at the risk of distraint; even those considering liquidation may have an obligation to shareholders to manage their affairs with their landlord in such a way as to try to protect the value of their saleable goods

Takeaways

- Careful consideration and sound advice in the early stages of insolvency can help avoid significant problems and can best protect the interests of both landlords and tenants
- Watch out for the early signs of insolvency (being unable to pay rent is a big one), monitor the economy and the markets, and pay close attention to financial recovery post August 2020
- Many businesses will survive this crisis; some will not. Landlords and tenants should be optimistic and clear eyed about what comes next.
- As Huey says: Cash is king

Questions?

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