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SCC Goes Out Of Its Way To Over-Rule *Cummer-Yonge*

Introduction

The decision of the Supreme Court of Canada in *Crystalline Investments v. Domgroup* (2004), 234 D.L.R. (4th) 513 appears to have ended the longstanding uncertainty in commercial leasing and bankruptcy circles caused by the Ontario High Court's decision in *Cummer-Yonge Investments v. Fagot*.

For almost 40 years, *Cummer-Yonge* has stood for the proposition that the disclaimer of a lease in bankruptcy extinguishes the lease obligations of both the bankrupt tenant and any guarantor of those obligations. This result is based on the view that the guarantor's obligations are "secondary" and rely on the continued existence of the tenant's "primary" obligations. In other words, since the tenant no longer has any obligations under the lease, there are no remaining obligations for the guarantor to guarantee.

In response to *Cummer-Yonge*, most commercial landlords rewrote their standard lease guarantee to take the form of an indemnity and adapted the language to characterize the guarantor/indemnifier's obligations as "primary" as opposed to "secondary". Also, these documents go to great lengths to confirm that the guarantor/indemnifier's obligations survive a bankruptcy-related termination of the tenant's obligations under the lease.

The Crystalline Decision

Crystalline considered the *Cummer-Yonge* principle in the context of a bankruptcy proposal, specifically a proposal under amendments to the *Bankruptcy and Insolvency Act* that permit a tenant to repudiate a commercial lease in order to reorganize its business. Unlike *Cummer-Yonge*, however, *Crystalline* dealt with the post-repudiation liability of the assignor of a lease, not a guarantor.

In *Crystalline*, the defendant entered into two leases, each with a different landlord in respect of a different property. The defendant subsequently assigned both leases to another corporation. These leases included an assignment clause which provided that the defendant remained fully liable for all obligations under the lease notwithstanding any assignment.

The assignee later became insolvent. Its trustee in bankruptcy filed a notice of intention to make a proposal pursuant to s. 65.2 of the *Bankruptcy and Insolvency Act* and delivered a notice of repudiation of the leases to the landlords. The landlords declined to exercise their right to object to the assignee's proposal and the court approved it.

Under the bankruptcy proposal, the landlords were paid the amount of compensation required by s. 65.2. The landlords then asserted their right to be paid the balance of the outstanding rent by the assignor (i.e., the defendant) based on the assignment clause in the leases.

The motions judge dismissed the landlords' claims. Relying on *Cummer-Yonge*, he held that the repudiation terminated the leases for all purposes. Consequently, the liabilities that would have been owed by the defendant also disappeared. The Ontario Court of Appeal overturned the motion judge's decision and the defendant appealed to the Supreme Court.

Speaking for a unanimous Supreme Court, Major J. held that the repudiation of the leases did not affect the obligations of the defendant under the lease. Specifically, he held that nothing in the *Bankruptcy and Insolvency Act* protected third parties, such as assignors, from the consequences of an insolvent assignee's repudiation of a commercial lease. Based on the assignment clauses in the leases, the defendant was liable for the lease obligations even though the leases had been assigned.

The court did find, however, that the defendant was entitled to exercise its common law right of indemnification against the insolvent assignee (albeit as an unsecured creditor).

Impact on Cummer-Yonge

While the court was only required to consider the post-repudiation liability of an assignor (not a guarantor) in *Crystalline*, Major J. went on to consider the decision in *Cummer-Yonge*. He stated at para. 39:

> *Cummer-Yonge* has created uncertainty in leasing and bankruptcy. Not only have drafters of leases attempted to circumvent the holding in *Cummer-Yonge* by playing upon the primary and secondary obligation distinction, but the courts have also performed what has been called "tortuous distinctions" in order to reimpose liability on guarantors.

Major J. pointed out that in *Cummer-Yonge*, the Ontario High Court applied the reasoning of the English Court of Appeal in *Stacy v. Hill*. He then stated at para. 42:

> The House of Lords went on to overrule *Stacey v. Hill*. In my opinion, *Cummer-Yonge* should meet the same fate. 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.

While Major J.'s statements are in *obiter*, there is little doubt that a lower court would feel compelled to follow the guidance offered by the SCC on this issue. Therefore, as a result of *Crystalline*, landlords and their counsel can take much more comfort that a guarantor or assignor will remain on the hook even if the tenant goes bankrupt and repudiates the lease. Now, the focus will be more squarely on dissecting the actual language of the lease guarantee or assignment clause.

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