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**"SHOW ME THE MONEY!  
(A.K.A. SECURITY FOR LEASES)"**

Prepared By: Joanna Board and Genevieve Wong  
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Breakfast Roundtable  
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**BREAKFAST ROUNDTABLE**  
**FEBRUARY 25-26, 2010**  
**HILTON TORONTO HOTEL**

**P R E S E N T E R S :**

***JOANNA BOARD***

Daoust Vukovich LLP  
3000-20 Queen Street West  
Toronto, ON M5H 3R3  
Tel: (416) 597-6888  
Fax: (416) 597-8897  
Direct: (416) 597-9225  
[jboard@dv-law.com](mailto:jboard@dv-law.com)

***GENEVIEVE WONG***

Cadillac Fairview Corporation  
250 Yonge Street  
Suite 610  
Toronto, ON M5B 2L7  
Tel: (416) 598-8788  
Fax: (416) 598-8528  
[wongg@cadillacfairview.com](mailto:wongg@cadillacfairview.com)

## TYPES OF SECURITY

1. **GUARANTEE V. INDEMNITY**
2. **RENT DEPOSIT V. SECURITY DEPOSIT**
3. **LETTER OF CREDIT**
4. **GENERAL SECURITY AGREEMENT & PPSA REGISTRATION**

### 1. GUARANTEE V. INDEMNITY

- A guarantee is a secondary obligation. In a bankruptcy, a guarantee does not survive the disclaimer of the tenant's lease and the guarantor is released (*Cummer-Yonge Investments v. Fagot* [1965] 2 O.R. 152, affirmed in the Court of Appeal).
- An indemnity is a primary obligation whereby the indemnifier is jointly liable with the tenant to perform the tenant's obligations under the Lease.
- A properly drafted indemnity will survive the bankruptcy of the tenant and disclaimer of the lease. (In *Andy & Phil Investments Ltd. v. Craig* [1991] O.J. No. 1926, the court held that the guarantor "signed as principal and not as surety". In *Sifton Properties Limited v. Dodson* [1994] O.J. 1856 the lease stated "the landlord may proceed against the indemnifier as if the indemnifier were named as tenant under this lease" and "no release or discharge of the tenant in any receivership, bankruptcy, winding up or other credit proceeding ....may reduce the obligations of the indemnifier under the covenants herein".
- In *Crystalline Investments Ltd. v. Domgroup Ltd.* [2004] 1 S.C.R. 60, the Supreme Court of Canada stated that *Cummer-Yonge* should be overruled.
- The indemnity agreement should specifically state that it survives the bankruptcy of the tenant.
- All surety contracts, to be enforceable, must be in writing (*Statute of Frauds* R.S.O. 1980, c. 481, s. 4).

## 2. RENT DEPOSIT V. SECURITY DEPOSIT

- A RENT DEPOSIT (a.k.a. prepaid rent deposit) is collected by the landlord and applied towards rent at specified times during the term (i.e. first and last).
- A SECURITY DEPOSIT is collected by the landlord as security for the tenant's performance of its obligations under the lease and may be applied against non-rental defaults (i.e. maintenance and repair obligations, unpaid utility bills, restoration obligations at the end of the term).
- For landlords, it is important to have the lease provide for a replenishment of the security deposit in the event that any portion of it is applied during the term.
- A security deposit should be returned to the tenant at the end of the term. For landlords, it is preferred that the security deposit clause state that it be returned 60/90 days after expiry of the lease term. This gives the landlord time to ensure that all restoration obligations have been fulfilled and that there are no outstanding additional rent charges.
- For tenants, ask for interest to accrue on the deposit.
- Landlord may not be able to charge G.S.T. when collecting rent and security deposits. It is suggested that a deposit should be quantified as a dollar amount (i.e. \$105.00) as opposed to \$100.00 deposit plus G.S.T.
- Consider drafting separate agreements for the rent and security deposits and provide that the deposit is the property of the landlord. If the tenant becomes bankrupt and the lease is disclaimed, arguably the obligations of the tenant are at an end and the landlord may not be entitled to hold onto the rent deposit.
- If the rent deposit states that it is pre-paid rent, the landlord will have a better chance of retaining the deposit in the event of the tenant's bankruptcy.

### 3. LETTER OF CREDIT

- For landlords:
  - i. lease should state that the L/C must be satisfactory to the landlord in both form and substance. Attach a draft L/C to the lease;
  - ii. lease should state that the bank who issues the L/C is satisfactory to the landlord;
  - iii. obtain the original L/C from the bank;
  - iv. ensure that the L/C is irrevocable (if not, bank can revoke the L/C at any time);
  - v. require the L/C to be transferable;
  - vi. have the L/C payable at a bank in the same city as the building or landlord's head office (must be physically present to cash in L/C);
  - vii. state that the L/C continues after the lease for 60/90 days as the landlord may need to cover damage to the premises that occur while the tenant is moving out. This also allows time to determine whether any additional rent charges are due;
  - viii. include a clause that the L/C automatically renews throughout the term of the lease and any renewals;
  - ix. have tenant restore draws;
  - x. ensure L/C states that partial draws are permitted or landlord is only entitled to one draw;
  - xi. ensure L/C states that it survives bankruptcy; and
  - xii. important that landlord may draw on letter of credit upon written request and not have to prove that tenant is in default.
- Letters of credit have been inconsistently treated where the tenant has gone bankrupt:
  - i. In *Titan Warehouse Club Inc. v. Glenview Corporation* [1988] O.J. No. 67, the L/C was provided to guarantee the rent

payable to the landlord for the first five years of the term of the lease. The court held that since the trustee had disclaimed the lease, the lease was no longer in existence and the landlord could not draw on the L/C;

- ii. In *885676 Ontario Ltd. v. Frasmet Holdings Inc.* [1993] O.J. No. 113 the court allowed the landlord to draw on a letter of credit and distinguished *Titan Warehouse* on the basis that the letter of credit in *Titan Warehouse* was only to cover the payment of rent whereas the L/C in the *Frasmet* lease covered the tenant's obligations under the lease;
- iii. In *Dunlop Construction Products Inc. v. Flavelle Holdings Inc.* [1996] O.J. No. 3775, the landlord was permitted to draw on a L/C to compensate for repairs to the premises despite the disclaimer of the lease; and
- iv. Re: *Peat Marwick Thorne v. Natco Trading Corporation* [1995] 22 O.R. (3d) 727 acknowledged that leases could be drafted so that guarantees could survive bankruptcy but decided in this case to follow the reasoning in *Cummer-Yonge*.

#### 4. GENERAL SECURITY AGREEMENT & PPSA REGISTRATION

- A secured creditor is defined as a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property as security for a debt due or accruing due to the person from the debtor...”.
- A general security agreement (GSA) is a security agreement granting a security interest in certain defined collateral (usually the assets of the tenant) to secure an obligation (the tenant's covenants under the lease).
- A secured creditor's main advantage is its ability to claim against the property in priority of all other creditors.
- Landlords will need to satisfy themselves that the tenant does in fact own the assets it claims its owns and that there are no other competing security interests that will take priority over the landlord's GSA (e.g. banks, equipment lessors, other secured creditors with prior registered security interests).

- Upon default, the GSA becomes enforceable once the landlord takes steps to seize the assets of the tenant.
- As a secured creditor, the landlord will rank ahead of unsecured creditors.
- Landlords should ensure that they register their GSA as soon as possible so that they can rank in priority to other creditors.
- Upon default, the landlord, as secured creditor, has the right to:
  - i. commence an action for arrears of payment;
  - ii. take possession;
  - iii. appoint a receiver and manager;
  - iv. retain the collateral; and
  - v. dispose of the collateral.
- In a bankruptcy, the landlord, as secured creditor, is not stayed from realizing on the assets of the tenant.