OMERS Realty Corporation v. The Fuller Landau Group Inc., in its Capacity as Trustee in Bankruptcy of 7636156 Canada Inc.

[Indexed as: OMERS Realty Corp. v. 7636156 Canada Inc.(Trustee in Bankruptcy of)]

Ontario Reports

Court of Appeal for Ontario

D.M. Brown, Paciocco and Nordheimer JJ.A.

October 28, 2020

153 O.R. (3d) 271 | 2020 ONCA 681

Case Summary

Bankruptcy and insolvency — Creditors and claims — Creditors — Preferred creditors — Appeal by landlord from decision limiting landlord's entitlement to draw on letter of credit posted as security by commercial tenant after disclaimer of lease by tenant's trustee in bankruptcy allowed — Despite trustee's disclaimer, landlord entitled to draw on full amount of letter of credit — Landlord's conduct in drawing on letter of credit did not engage fraud exception to principle of the autonomy of letters of credit — Motion judge erred interpreting lease provision regarding reduction of letter of credit — Pre-conditions for reduction of letter of credit under lease not met.

Landlord and tenant-- Commercial tenancies — Contractual remedies — Recovery of losses from third parties — Letter of credit — Appeal by landlord from decision limiting landlord's entitlement to draw on letter of credit posted as security by commercial tenant after disclaimer of lease by tenant's trustee in bankruptcy allowed — Despite Trustee's disclaimer, landlord entitled to draw on full amount of letter of credit — Landlord's conduct in drawing on letter of credit did not engage fraud exception to principle of the autonomy of letters of credit — Motion judge erred interpreting lease provision regarding reduction of letter of credit — Pre-conditions for reduction of letter of credit under lease not met.

Appeal by the landlord from a decision of a motion judge limiting the landlord's entitlement to draw on a letter of credit posted as security by the commercial tenant after the disclaimer of the lease by the tenant's trustee in bankruptcy. The landlord made draws on the letter of credit after the tenant's bankruptcy, both before and after the trustee's disclaimer of the lease, for the full amount of the credit of $2.5 million. On a motion brought by the trustee, the motion judge determined that the landlord was only entitled to draw on the letter of credit to recover the amount of its preferred claim for three months' accelerated rent under s. 136(1) (*f*) of the *Bankruptcy and Insolvency Act*. In the alternative, the motion judge concluded that, in accordance with the terms of the lease, the letter of credit should have been reduced to $1.35 million in May 2017, just under a year prior to the date of bankruptcy, based on his interpretation

of the letter of credit reduction provisions in the lease, with the landlord's draws limited to the reduced amount. The lease provided the letter of credit could be reduced in the 37th month if the tenant had at all times promptly paid all rent through the term. The tenant had failed to pay rent of twice on the due date prior to May 2017. The motion judge interpreted prompt to mean within a reasonable time.

Held, the appeal should be allowed.

Despite the Trustee's disclaimer of the lease, the landlord was entitled to draw on the full amount of the letter of credit. The bank treated the landlord's drafts on the letter of credit as complying presentations, thereby triggering its obligation to pay. The landlord's conduct in drawing on the letter of credit did not engage the fraud exception to the principle of the autonomy of letters of credit. In the lease, the parties agreed that the letter of credit would continue to stand as security in the event the tenant became bankrupt and the lease was disclaimed in the bankruptcy proceeding. The terms of the lease and letter of credit clearly gave the landlord the right to draw on the letter of credit for losses arising from the disclaimer of the lease in the tenant's bankruptcy proceeding. There was no evidence that the landlord acted with impropriety, dishonesty, or deceit. Under the legal principles governing letters of credit, the landlord was entitled to draw on the letter of credit to the amount available. The principles of insolvency law did not override the autonomy of letters of credit so as to limit the right of a landlord to draw on a letter of credit to a claim for three months' accelerated rent. The motion judge also erred in interpreting the lease to require a reduction of the amount of letter of credit in May 2017. The tenant had not satisfied the pre-conditions for a reduction in the value of the letter of credit under the lease. The motion judge did not take into account several provisions of the lease that were relevant to the interpretation of the word promptly and did not support the motion judge's interpretation of the word promptly to mean within a reasonable time rather than on the actual date the rent was due. When considered in light of the whole lease, promptly meant payment of rent when due. As the tenant had failed to pay rent when due on two occasions, the pre-conditions for a reduction in the value of the letter of credit had not been met.

Cases referred to

Canada (Attorney General) v. Bedford, [2013] 3 S.C.R. 1101, [2013] S.C.J. No. 72, 2013 SCC 72, 366 D.L.R. (4th) 237, 452 N.R. 1, 312 O.A.C. 53, 303 C.C.C. (3d) 146, 7 C.R. (7th) 1, 297 C.R.R. (2d) 334; *R. c. Leblanc*, [2018] J.Q. no 8412, 2018 QCCQ 6481, EYB 2018-301810, 2018EXP-2633; *R. v. Almond*, [2006] B.C.J. No. 2998, 2006 BCSC 1706 (S.C.); *R. v. Antoine*, [2019] O.J. No. 3325, 2019 ONSC 3843 (S.C.J.); *R. v. Anwar*, [2020] O.J. No. 820, 2020 ONCJ 103, 62 C.R. (7th) 402, 454 C.R.R. (2d) 52 (C.J.); *R. v. Boodhoo*, [2018] O.J. No. 6413, 2018 ONSC 7205, 51 C.R. (7th) 207 (S.C.J.); *R. v. Borde* (2003), 63 O.R. (3d) 417, [2003] O.J. No. 354, 186 O.A.C. 317, 172 C.C.C. (3d) 225, 8 C.R. (6th) 203 (C.A.); *R. v. Briscoe*, [2010] 1 S.C.R. 411, [2010] S.C.J. No. 13, 2010 SCC 13, 400 N.R. 216, 210 C.R.R. (2d) 150, 316 D.L.R. (4th) 577, 253 C.C.C. (3d) 140, 477 A.R. 86, 73 C.R. (6th) 224, 22 Alta. L.R. (5th) 49, [2010] 6 W.W.R. 1; *R. v. Butler-Antoine*, [2020] O.J. No. 2504, 2020 ONCA 354 (C.A.); *R. v. D. (B.)*, [2008] O.J. No. 6040 (C.J.); *R. v. D'Souza*, [2016] O.J. No. 4992, 2016 ONSC 2749, 339 C.C.C. (3d) 494 (S.C.J.); *R. v. Daoust*, [2004] 1 S.C.R. 217, [2004] S.C.J. No. 7, 2004 SCC 6, 235

D.L.R. (4th) 216, 316 N.R. 203, 180 C.C.C. (3d) 449, 18 C.R. (6th) 57; *R. v. Downes* (2006), 79 O.R. (3d) 321, [2006] O.J. No. 555, 208 O.A.C. 324, 205 C.C.C. (3d) 488, 37 C.R. (6th) 46 (C.A.); *R. v. Ferguson*, [2008] 1 S.C.R. 96, [2008] S.C.J. No. 6, 2008 SCC 6, 228 C.C.C. (3d) 385, [2008] 5 W.W.R. 387, 371 N.R. 231, 290 D.L.R. (4th) 17, 425 A.R. 79, 54 C.R. (6th) 197, 87 Alta. L.R. (4th) 203, 168 C.R.R. (2d) 34;

Statutes referred to

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 30(1)(*k*) [as am.], 136 [as am.], (1) (*f*) [as am.], 146 [as am.], 179 [as am.]

Commercial Tenancies Act, R.S.O. 1990, c. L.7, ss. 38(1), 39(1)

Personal Property Security Act, R.S.O. 1990, c. P.10 [as am.]

Authorities referred to

Bird, Clive S. and Andersen, Kendall E., "Various Landlord Issues in British Columbia Insolvencies" *(*2003), Insolvency Institute of Canada Article 2003-10

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APPEAL from the order of Hainey J., [2019] O.J. No. 5403, 2019 ONSC 6106, 74 C.B.R. (6th) 312.

John Finnigan, *D.J. Miller* and *Scott McGrath*, for appellant.

Harvey Chaiton and *Sam Rappos*, for respondent.

The judgment of the court was delivered by
D.M. BROWN J.A.: —

I. OVERVIEW

[1] The main issue raised on this appeal concerns the right of a commercial landlord to draw on a letter of credit, posted as security by its tenant, following the disclaimer of the lease by the tenant's trustee in bankruptcy.

[2] 7636156 Canada Inc., previously known as RM2 Canada Inc. (the "Tenant"), leased an industrial building from the appellant, OMERS Realty Corporation (the "Landlord"). The Tenant made an assignment in bankruptcy on May 1, 2018. The respondent, The Fuller Landau Group Inc. (the "Trustee"), was appointed trustee of the bankrupt Tenant's estate. The Trustee, pursuant to statutory authority,[1] disclaimed the lease on July 23, 2018.

[3] Pursuant to the terms of the lease, the Tenant had put in place a $2.5 million letter of credit from the Bank of Nova Scotia ("BNS") in favour of the Landlord (the "LOC"). The Landlord made draws on the LOC after the Tenant's bankruptcy, both before and after the Trustee's disclaimer of the lease. The draws were for the full amount of the credit.

[4] On a motion brought by the Trustee, the motion judge determined that the Landlord was only entitled to draw on the LOC to recover the amount of its preferred claim for three months' accelerated rent under s. 136(1)(*f*) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").[2] In the alternative, the motion judge concluded that, in accordance with the terms of the lease, the LOC should have been reduced to approximately $1.35 million on May 1, 2017 (just under a year prior to the date of bankruptcy), with the Landlord's draws limited to the reduced amount.

[5] The Landlord appeals. It submits that the independent obligations created by the LOC between the issuer bank, BNS, and itself as beneficiary were not affected by the Trustee's disclaimer of the lease. Nor, on a proper interpretation of the lease, did the amount of the LOC reduce in May 2017.

[6] For the reasons set out below, I would allow the appeal. I conclude that, notwithstanding the Trustee's disclaimer of the lease, the Landlord was entitled to draw on the full amount of the LOC. I also conclude that the motion judge erred in interpreting the lease to require a reduction of the amount of the LOC on May 1, 2017.

II. FACTS

A. *The Lease*

[7] The Landlord owns an industrial building located at 71 Royal Group Crescent, Vaughan, Ontario (the "Premises"), which it leased to the Tenant by lease dated February 18, 2014 (the

"Lease"). The term of the Lease was ten years, commencing on May 1, 2014 and expiring on the last day of April 2024.

[8] Schedule C of the Lease contains "Supplemental Terms and Conditions". Section 2(a) of Schedule C requires the Tenant to arrange a letter of credit in the amount of $2.5 million in favour of the Landlord as beneficiary for an initial term of one year, renewed annually on an automatic basis until 60 days after the expiry of the Lease's term. Section 2(a) stipulates that the LOC is to continue to stand as security should the Tenant become bankrupt. Sections 2(a) and (b) also contain provisions dealing with the reduction in the value of the LOC during the term of the Lease. I will review the terms of s. 2 of the Lease in some detail later in these reasons.

B. *The Letter of Credit*

[9] In accordance with the terms of the Lease, the Tenant arranged for the LOC, an irrevocable standby letter of credit issued by BNS on May 2, 2014 in the amount of $2.5 million in favour of the Landlord as beneficiary. The LOC was renewed each year prior to the date of bankruptcy. I will describe the terms of the LOC later in these reasons.

[10] The Tenant pledged cash collateral in the amount of $2.5 million to BNS in support of the LOC, which was held in a GIC pursuant to an Authority to Hold Funds on Deposit agreement. BNS registered a financing statement against the Tenant under the *Personal Property Security Act*, R.S.O. 1990, c. P.10 ("*PPSA*"). The Trustee has not disputed the validity of the BNS security.

[11] As of the date of the Tenant's assignment in bankruptcy, no reduction had been made in the amount of the LOC.

C*. The bankruptcy of the Tenant*

[12] On May 1, 2018, the Tenant made an assignment in bankruptcy and the Trustee was appointed. On July 23, 2018, the Trustee disclaimed the Lease.

D. *Events relating to payments under the Lease*

[13] As of the date of bankruptcy, there were no arrears of rent owing under the Lease.

[14] Following the Tenant's assignment in bankruptcy, the Landlord made three demands to draw on the LOC up to its full amount of $2.5 million. The first draw, in the amount of $207,732.28, was made on May 16, 2018, before the disclaimer of the Lease. The second draw, in the amount of $1,709,768.40, occurred on December 4, 2018, and the third, in the amount of $582,499.32, on April 2, 2019. The draws covered the following losses claimed by the Landlord:

(a) $207,732.28 for rent for May 2018;

(b) $1,621,160.72 for rent for the months of August 2018 through to and including April 2019;

(c) $368,479 for the unamortized cost for the Landlord Allowance as per the terms of the Lease, inclusive of interest; and

(d) $302,628 for restoration costs, as per the terms of the Lease.

[15] In support of each demand, the Landlord provided BNS with a certificate confirming the indebtedness of the Tenant under the Lease and that the amount "is due and payable to the Beneficiary by [the Tenant], payment of which has been requested from [the Tenant] and has not been received".

[16] BNS accepted the Landlord's draws under the LOC and paid out the full amount of the LOC. BNS has never asked the Landlord to return the funds paid out.

[17] A day after the first draw on the LOC, the Landlord filed a proof of claim with the Trustee for a priority claim under *BIA* s. 136(1)(*f*) in the amount of $623,196.84 for three months' accelerated rent: May, June, and July 2018. Under *BIA* s. 146, the rights of lessors are to be determined according to the law of the province in which the leased premises are situated, subject to the priority ranking of the landlord's preferred claim under *BIA* s. 136. Section 38(1) of the *Commercial Tenancies Act*, R.S.O. 1990, c. L.7 ("*CTA*") limits a landlord's preferential lien for rent in the event of a tenant's bankruptcy to rental arrears for three months pre-bankruptcy and accelerated rent for three months post-bankruptcy. *BIA* s. 136(1)(*f*) creates a preferred claim for a landlord similar in scope.

[18] The Landlord's proof of claim attached a schedule explaining the Landlord's position that it was entitled to make draws under the LOC.

[19] On October 3, 2018 the Trustee disallowed the Landlord's proof of claim, stating that the Landlord's preferred claim for three months' accelerated rent had been satisfied by the Landlord's May 2018 draw on the LOC and the Trustee's authorization of an additional partial draw for the balance of the preferred claim. The disallowance went on to state that (i) the funds used to pay draws made against the LOC came from funds that belonged to the bankrupt Tenant; (ii) the amount of the LOC should have been reduced by $1.14 million on May 1, 2017; and (iii) the Landlord had failed to provide the Trustee with evidentiary support for its claims for further damages in respect of the Tenant's obligations under the Lease.

[20] The Landlord appealed the disallowance to the Registrar in Bankruptcy. By reasons dated December 27, 2018, Master Mills allowed the Landlord's appeal in part*: In re: 7636156 Canada Inc.*, 2018 ONSC 7737. She held that since the Landlord had drawn on the LOC for the May 2018 rent, the Trustee properly disallowed its preferred claim for that month. However, the Landlord was entitled to assert its claim for accelerated rent for the other two months either against the proceeds of the estate or by a further draw on the LOC. According to the Master, the Trustee therefore improperly disallowed the preferred claim of $415,464.56 for those two months: at paras. 19 and 25.

E. *Events concerning the reduction in the value of the LOC*

[21] In late May 2018, the Trustee advised the Landlord of its position that the cash collateral pledged to BNS was an asset of the bankrupt Tenant that vested in the Trustee, subject to BNS' secured claim. As well, the Trustee asserted that the terms of the Lease mandated an automatic reduction in the amount of the LOC to $1.14 million on May 1, 2017, the start of the 37th month of the term. The Trustee requested the Landlord to authorize BNS to reduce the LOC by that

amount. On the other hand, if the Landlord drew on the LOC beyond the reduced amount, the Trustee advised it would challenge such draws as unjust enrichment.

[22] The Landlord disputed the Trustee's position, contending that under the Lease reductions in the amount of the LOC were permissive, not mandatory. In any event, the Landlord took the position that the Tenant had been delinquent in the payment of rent prior to May 1, 2017 and so was not entitled to a reduction in the value of the LOC. Specifically, the Landlord provided evidence that the rent payment due February 1, 2015 was not paid until February 3, 2015 and the rent due on July 1, 2015 was not paid until July 2, 2015.

III. The Trustee's Motion

A. *The Motion*

[23] The Trustee moved for a determination of the amount that the Landlord was entitled to draw on the LOC. In the event the court found that the Landlord had drawn more than it was entitled to on the LOC, the Trustee sought orders directing the Landlord to pay the excess to the Trustee and for BNS to release to the Trustee the remaining cash collateral for the LOC. Although served, BNS did not participate in the motion.

[24] Before the motion judge, the parties largely advanced the positions set out in their respective proof of claim and notice of disallowance.

B. *The Motion Judge's Reasons*

[25] The motion judge concluded that the Landlord was only entitled to draw on the LOC for three months' accelerated rent under *BIA* s. 136(1)(*f*): at para. 18. In his reasons, the motion judge

(i) stated that a disclaimer of lease by a trustee in bankruptcy operates as a voluntary surrender of the lease by the tenant with the consent of the landlord, which extinguishes all obligations of the tenant under the lease: at para. 24;

(ii) rejected the Landlord's submissions that (a) the autonomous obligation of BNS to it under the LOC meant that the proceeds of the LOC were not the property of the bankrupt Tenant; and (b) the Trustee had no legal right to obtain redress from the Landlord under the LOC: at paras. 31-33;

(iii) affirmed that upon the disclaimer of a lease by a trustee, a bankrupt tenant no longer owes any obligations to the landlord under the lease, with the result that the landlord is not entitled to draw on a letter of credit provided as security under the lease for any amounts in excess of the landlord's three months' accelerated rent preferred claim under s. 136(1)(*f*) of the *BIA*: at para. 39; and

(iv) determined that this conclusion was not affected by the decision of the Supreme Court of Canada in *Crystalline Investments Ltd. v. Domgroup Ltd.*, [2004] 1 S.C.R. 60, 2004 SCC 3 because the obligation of BNS, as issuer of the LOC, to make payment to the Landlord beneficiary "was wholly dependent on the continued existence of the Bankrupt's

obligations to the Landlord under the Lease. BNS had no independent obligation to make any payment to the Landlord pursuant to the (LOC) unlike an assignor or guarantor who has its own independent contractual obligations with a landlord to perform the tenant's obligations under the Lease": at paras. 40 and 44.

[26] In reaching these conclusions, the motion judge relied on case law from this and other courts, which I will discuss in some detail later in these reasons.

[27] The motion judge stated that in the event his decision was held to be incorrect, he would have reduced the amount of the LOC to $1,357,135.53 based on his interpretation of the LOC reduction provisions in the Lease: at paras. 47-51.

[28] In the result, the motion judge ordered the Landlord to pay the Trustee $1,876,803.14, being the $2.5 million of the LOC less three months' accelerated rent of $623,196.84.

IV. THE ISSUES ON THIS APPEAL AND THE STRUCTURE OF THE ANALYSIS

[29] This appeal raises two issues:

(1) Issue 1: Did the motion judge err in holding that, upon the disclaimer of the Lease by the Trustee, the Landlord was not entitled to draw on the LOC for amounts in excess of the Landlord's preferred claim under s. 136(1)(*f*) of the *BIA*?

(2) Issue 2: Did the motion judge err in holding that on May 1, 2017 the amount of the LOC was reduced to $1,357,135.53?

[30] As I will explain, my answer to both questions is "yes".

[31] I will divide the analysis of Issue 1 into two parts:

(a) Under Issue 1(a), I consider the extent of the Landlord's right to draw on the LOC under the principles governing standby letters of credit. I conclude that BNS treated the Landlord's drafts on the LOC as "complying presentations",[3] thereby triggering its obligation to pay. I also conclude that the Landlord's conduct in drawing on the LOC did not engage the fraud exception to the principle of the autonomy of letters of credit. Under the legal principles governing letters of credit, the Landlord was entitled to draw on the LOC to the amount available;

(b) Under Issue 1(b), I determine that this conclusion is not altered by the principles of insolvency law, in particular those concerning the effect of a trustee's disclaimer of a commercial property lease. I do not accept the Trustee's argument that, where the trustee of a bankrupt tenant has disclaimed a lease, the principles of insolvency law override the autonomy of letters of credit so as to limit the right of a landlord to draw on a letter of credit to a claim for three months' accelerated rent.

[32] The final section of these reasons will deal with Issue 2, namely, whether the motion judge erred in holding that the terms of the Lease required a reduction in the value of the LOC on May 1, 2017. In my respectful view, the motion judge committed an error on an extricable

question of law in interpreting the Lease. As a result, I conclude that the Landlord was entitled to draw the full $2.5 million under the LOC.

V. ISSUE 1(A): THE LANDLORD'S ENTITLEMENT TO DRAW UNDER THE PRINCIPLES GOVERNING STANDBY LETTERS OF CREDIT

A. *The positions of the Parties*

[33] On the motion below, the Landlord argued that the "autonomy principle" for letters of credit precluded the Trustee from obtaining redress in respect of the LOC. The motion judge did not accept that submission: at para. 33. On appeal, the Landlord renews that submission.

[34] The Trustee, on the other hand, argued that the "fraud exception" to the autonomy principle applied to prevent the Landlord from drawing on the LOC. The motion judge did not find it necessary to deal with that issue. Before us, the Trustee renews its submission that it was entitled to challenge draws by the Landlord under the fraud exception "as the Landlord had no right to make a demand under the [LOC] following the disclaimer of the Lease, other than for three months' accelerated rent".

[35] Before explaining why I reject the Trustee's submission that the "fraud exception" applies, I begin by discussing the nature of standby letters of credit, what is meant by the autonomy principle and the related notion of a complying presentation, and the fraud exception. I will then set out why the fraud exception does not apply in the circumstances of this case, with the result that the Landlord is entitled to draw on the LOC under the principles governing letters of credit.

B. *The Governing Legal Principles*

Standby letters of credit and the autonomy principle

[36] The LOC is a standby letter of credit, which consists of an undertaking by the issuing bank, BNS, to honour drafts or other demands for payment by the beneficiary Landlord upon compliance with the conditions specified in the credit: Kevin McGuinness, *The Law of Guarantee*, 3rd ed. (Toronto: LexisNexis, 2013), at §16.4.

[37] By its terms, the LOC was subject to the version of the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits ("UCP") in effect on the date it was issued by BNS, which was the 2007 Revision, ICC Publication no. 600 ("UCP 600"). Under article 1 of UCP 600, the rules for documentary credits apply to any standby letter of credit.

[38] The formation of a standby letter of credit involves three parties: the account customer of the issuing bank who applies for the credit, in this case the Tenant; the issuing bank, BNS; and the beneficiary of the credit, the Landlord. A standby letter of credit is a performance-securing mechanism in that it constitutes an obligation of the issuer to the beneficiary to make payment on account of any default by the applicant customer in the performance of an obligation upon certification by the beneficiary that the applicant has failed to fulfil its obligations to the beneficiary: McGuinness, at §16.45. As such, the starting point in any standby letter of credit

transaction is the formation of an underlying contract between the applicant customer of the issuing bank and the beneficiary of the credit.

[39] Nevertheless, a fundamental characteristic of standby letters of credit is their autonomy from the underlying transaction between the applicant and the beneficiary. This critical characteristic was explained by the Supreme Court of Canada in *Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, [1987] 1 S.C.R. 59, at pp. 70 and 103:

> The fundamental principle governing documentary letters of credit and the characteristic which gives them their international commercial utility and efficacy is that the obligation of the issuing bank to honour a draft on a credit when it is accompanied by documents which appear on their face to be in accordance with the terms and conditions of the credit is independent of the performance of the underlying contract for which the credit was issued. *Disputes between the parties to the underlying contract concerning its performance cannot as a general rule justify a refusal by an issuing bank to honour a draft which is accompanied by apparently conforming documents. This principle is referred to as the autonomy of documentary credits*.
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> . . . . .
>
> [I]t is essential that [the issuing bank's] obligation to pay should not be subject to determination after the event by what actually transpired in the performance of the underlying contract. That is the other side of the principle of autonomy. The obligation of the issuing bank to the beneficiary of a credit must at all times be independent of the actual performance of the underlying contract.

(Emphasis added)

[40] Article 4(a) of UCP 600 elaborates on the autonomy of the obligation arising between the issuing bank and the beneficiary:

> A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such a contract, *even if any reference whatsoever to it is included in the credit*. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary.

(Emphasis added)

Article 5 reinforces the autonomous character of a letter of credit by stating that "[b]anks deal with documents and not with goods, services or performance to which the documents may relate".

[41] The autonomous nature of letters of credit is essential for their commercial risk-minimization function. As described by McGuinness, at §16.47:

> The beneficiary of a letter of credit obtains a gold standard of payment assurance for the underlying commercial transaction. Stand-by letters of credit create a potential obligation for the issuer that is completely independent of the business arrangement for which it was an inducement.

[42] A standby letter of credit is drafted to define the scope and terms of the issuer's undertaking so that the issuer need only examine the terms of the letter of credit and the documents presented by the beneficiary to determine whether there is a liability to pay: McGuinness, at §16.44. When the documents specified under a letter of credit are delivered, or "presented", to an issuing bank, the bank must examine the presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a "complying presentation": UCP 600, arts. 2 and 14(a). When an issuing bank determines that a presentation is complying, it must honour: UCP 600, arts. 7(a) and 15(a). When an issuing bank determines that a presentation does not comply, it may refuse to honour, in which case it must give a single notice to that effect to the presenter: UCP 600, arts. 16(a) and 16(c).

The fraud exception to the principle of autonomy of letters of credit

[43] An exception exists to the general rule that an issuing bank is obliged to honour a draft under a documentary credit when the tendered documents appear on their face to be regular and in conformity with the terms and conditions of the credit. The exception arises in the case of fraud by the beneficiary which has been (a) sufficiently brought to the knowledge of the bank before payment of the draft; or (b) demonstrated to a court called on by the customer of the bank to issue an interlocutory injunction to restrain the bank from honouring the draft: *Angelica-Whitewear*, at p. 71.

[44] In *Angelica-Whitewear*, the Supreme Court described the scope of the fraud exception, at p. 83:

> In my opinion the fraud exception to the autonomy of documentary letters of credit should not be confined to cases of fraud in the tendered documents but should include fraud in the underlying transaction of such a character as to make the demand for payment under the credit a fraudulent one . . . In my view the fraud exception to the autonomy of a documentary credit should extend to any act of the beneficiary of a credit the effect of which would be to permit the beneficiary to obtain the benefit of the credit as a result of fraud.

[45] The beneficiary under a letter of credit is not entitled to make a demand for payment under a letter of credit where there is no right to make such demand as between the beneficiary and the applicant under the terms of the underlying contract: McGuinness, at §17.338. However, given the principle of the autonomy of letters of credit, the fraud exception is carefully constrained to protect the commercial utility of the letter of credit: *430872 B.C. Ltd. v. KPMG Inc.*, 26 B.C.L.R. (4th) 203, 2004 BCCA 186, at paras. 30-31. The fraud exception does not encompass a demand for payment made in the face of a legitimate contractual dispute but requires some impropriety, dishonesty or deceit, which would include instances where the demand can be said to be clearly untrue or false, utterly without justification, or made where it is apparent that there is no right of payment: *Royal Bank v. Gentra Canada Investments Inc.* (2001), 147 O.A.C. 96 (C.A.), at para. 8; *Cineplex Odeon Corp. v. 100 Bloor West General Partner Inc.*, [1993] O.J. No. 112 (Gen. Div.), at paras. 31-32; McGuinness, at §17.343.

[46] In a case where no application is made for an injunction to restrain payment under a letter of credit and the issuing bank has to exercise its own judgment about whether to honour a draft, establishing the fraud exception requires showing that the "fraud was so established to the knowledge of the issuing bank before payment of the draft as to make the fraud clear or obvious to the bank": *Angelica-Whitewear*, at p. 84. As Blair J. (as he then was) put the matter in *Cineplex Odeon*, "the exception is 'fraud', not something less than fraud": at para. 29.

[47] When presented with documents that appear on their face to be regular, an issuing bank has no duty to satisfy itself by independent inquiry that the beneficiary has not engaged in fraud. It is only when the fraud appears on the face of the documents or when fraud has been brought to its attention by its customer or some other interested party that the bank must decide whether fraud has been established requiring it to refuse payment: *Angelica-Whitewear*, at p. 88.

C. *Analysis*

[48] Does the fraud exception apply in this case, as the Trustee contends? In arguing that it was entitled to challenge the draws by the Landlord under the fraud exception, the Trustee does not submit that there was a fraud in the documents tendered by the Landlord to BNS. In oral argument, the Trustee acknowledged that the documentation submitted by the Landlord to BNS accorded with the terms of the LOC. The Trustee's acknowledgment is understandable. The LOC authorized the Landlord to draw on BNS by a draft at sight that was accompanied by "your signed statement certifying that the amount drawn under this [LOC] is due and payable to you by [the Tenant] that you have requested payment of the said amount from [the Tenant] and have not received payment". BNS honoured each of the presentations made by the Landlord. The only inference available from the record is that BNS concluded that the documents presented by the Landlord appeared on their face to constitute complying presentations.

[49] Instead, the Trustee appears to contend that the Landlord engaged in a fraud related to the transaction between it and the Tenant. Specifically, the Trustee alleges that certificates that the Landlord presented to BNS were "clearly untrue or false" since they stated that the Tenant had defaulted in its obligations under the Lease after the Trustee had disclaimed it. Accordingly, the Landlord had no right to make demands on the LOC when it did, with the result that its conduct fell within the fraud exception to the autonomy principle.

[50] I am not persuaded by the Trustee's argument. The statements by the Landlord in the certificates it presented to BNS were not "clearly untrue or false" when assessed in the context of the underlying contract (the Lease) between the beneficiary (the Landlord) and the applicant (the Tenant).

[51] The Lease required the Tenant to post the $2.5 million LOC. Section 2(a) of Schedule C to the Lease describes the purpose of the LOC:

> The [LOC] shall be held by Landlord as *security for indemnification of Landlord in respect of any losses, costs or damages incurred by Landlord* arising out of the failure by Tenant to pay Annual Rent or any other amounts payable under this Lease or resulting from any failure by Tenant to observe or perform any obligations contained in this Lease or resulting from any default under this Lease or *resulting from any termination, surrender, disclaimer or*

repudiation of this Lease whether by Landlord as a result of the default of Tenant or in connection with any insolvency or bankruptcy of Tenant or otherwise.

(Emphasis added)

[52] In the Lease, the parties agreed that the LOC would continue to stand as security in the event the Tenant became bankrupt and the Lease was disclaimed in the bankruptcy proceeding. Section 2(*a*) states, in part:

If at any time during the term of the [LOC], Tenant defaults in the payment of any Annual Rent or other amounts payable under this Lease or in the performance of any of its other obligations under this Lease or *if this Lease is surrendered, terminated, disclaimed or repudiated whether by Landlord as a result of default of Tenant or in connection with any insolvency or bankruptcy of Tenant or otherwise, then Landlord at its option may*, in addition to any and all other rights and remedies provided for in this Lease or at law, *draw a portion of or all of the Principal Amount of the [LOC], whereupon the proceeds thereof shall be applied firstly towards repayment of the cost of Landlord's Work*[4] *and other costs referred to above, secondly to compensate Landlord for damages suffered by it as the result of Tenant's default*, and the balance, if any, will be returned to Tenant.
The rights of Landlord hereunder, in respect of the [LOC], shall continue in full force and effect and shall not be waived, released, discharged, impaired or *affected by reason of the release or discharge of Tenant in any* receivership, *bankruptcy*, insolvency, winding-up or other creditors' proceedings including, without limitation, any proceedings under the Bankruptcy and Insolvency Act (Canada) or the Companies Creditors' Arrangement Act (Canada), *or the surrender, disclaimer, repudiation or termination of the Lease in any such proceedings and shall continue with respect to the periods prior thereto and thereafter as if the Lease had not been surrendered, disclaimed, repudiated, or terminated*.

(Emphasis added)

[53] The LOC tracked the parties' agreement by stating that it was issued "in connection with lease payments and lease defaults for" the Premises. It authorized the Landlord to draw on BNS up to $2.5 million, which would be

available by your drafts at sight, indicating L/C number and date, accompanied by:

-- Your signed statement certifying that the amount drawn under this Credit is due and payable to you by [the Tenant] that you have requested payment of the said amount from [the Tenant] and have not received payment.

-- The original of this Credit.

[54] Significantly, the LOC also stated that:
This Credit will not be released, discharged or affected by the bankruptcy, receivership or insolvency of [the Tenant] or by [the Tenant] ceasing to exist . . . nor by any disclaimer or repudiation of the [Tenant] lease with you.

[55] Accordingly, the agreement between the Landlord and Tenant was that the rights of the Landlord under the Lease in respect of the LOC would continue in full force and effect in the event of the Tenant's bankruptcy, and any disclaimer therein, as if the Lease had not been disclaimed. The terms of the Lease and LOC clearly gave the Landlord the right to draw on the LOC for losses arising from the disclaimer of the Lease in the Tenant's bankruptcy proceeding.[5] The Landlord presented such drafts and BNS honoured them as complying presentations.

[56] An additional reason for rejecting the Trustee's submission that the fraud exception applies concerns the Landlord's conduct when it made the draws under the LOC. The record does not contain any evidence that the Landlord acted with impropriety, dishonesty or deceit. In the schedule to its May 17, 2018 proof of claim, the Landlord transparently informed the Trustee of the legal basis upon which it was acting:

> The Creditor is the beneficiary of a letter of credit in the amount of $2,500,000.000 issued by the Bank of Nova Scotia ("Scotia Bank") dated May 2, 2014 (the "LOC"). The Creditor does not regard the LOC as an asset or property belonging to the estate of the Debtor. Rather, the Creditor regards the LOC as a contract as between it and Scotia Bank, and that contract is independent of any relationship between the Creditor and the Debtor. The funds are the property of Scotia Bank, not the Debtor. The trustee therefore does not have a claim on the undrawn portion of the security represented by the LOC.

[57] Although the Trustee disagreed with that position, the most one can say is that the Landlord made demands for payment on the LOC in the face of a legitimate contractual dispute with its Tenant's Trustee.

D. *Conclusion on Issue 1(a)*

[58] Applying the principles governing letters of credit, I conclude that when the conduct of the Landlord in drawing the LOC, assessed in light of the language of the Lease and LOC, is measured against the rigorous standard of proof applicable to establish the fraud exception to the autonomy principle, the Trustee has not demonstrated that the Landlord's conduct fell within the fraud exception to the principle of autonomy of letters of credit.

VI. ISSUE 1(B): THE EFFECT OF THE TRUSTEE'S DISCLAIMER OF THE LEASE

[59] That conclusion leads to the next issue, which I perceive stands at the centre of the Trustee's challenge to the draws made by the Landlord. The Trustee argues, in effect, that when it disclaimed the Lease, the Landlord was thereupon precluded by the operation of insolvency law from drawing on the LOC for any amount in excess of the Landlord's preferred claim for three months' accelerated rent. The Trustee contends that such a principle of insolvency law overrides the autonomy principle for letters of credit and imposes a legal limit on the amount the Landlord could draw. I shall now consider this argument by the Trustee.

A. *The Jurisprudence on the Effect of a Trustee's Disclaimer of Lease*

[60] Based on his review of the case law starting with the decision in *Re Mussens Ltd.*, [1933] O.W.N. 459 (S.C.), the motion judge held it is settled law in Ontario that a disclaimer of a lease by a trustee in bankruptcy "operates as a voluntary surrender of the lease by the tenant with the consent of the landlord, which extinguishes all obligations of the tenant under the lease": at para. 24. That led the motion judge to conclude the following, at para. 39:

> [T]he law of the Province of Ontario remains that, upon the disclaimer of a lease by a trustee in bankruptcy, the bankrupt no longer has any obligations owing to the landlord under the lease, and the landlord is not entitled to draw on a letter of credit provided as security under the lease for any amounts in excess of the Landlord's three months' accelerated rent preferred claim under s. 136(1)(*f*) of the *BIA*.

[61] As I will first explain, in this passage the motion judge overstated the effect of a trustee's disclaimer of a lease, in part because he did not have the benefit of this court's decision in *Curriculum Services Canada/Service Des Programmes D'Études Canada (Re)* (2020), 150 O.R. (3d) 529, 2020 ONCA 267. I will then explain why the motion judge erred in limiting the Landlord's ability to draw on the LOC to its preferred claim under *BIA* s. 136(1)(*f*).

[62] *Curriculum Services* clarified that a trustee's disclaimer does not operate as a voluntary surrender of a lease with the consent of the landlord for all purposes. The decision contains an extensive review of the case law concerning the effect of the disclaimer of a lease by a trustee in bankruptcy on a landlord's ability to claim for amounts owing under the lease. The review starts with *Re Mussens* and proceeds through *Cummer-Yonge Investments Limited v. Fagot*, [1965] 2 O.R. 152 (S.C.), aff'd [1965] 2 O.R. 157n (C.A.) and *Crystalline Investments*, decisions which the motion judge also considered in this case. There is no need to repeat that exercise. Suffice it to say that its review of the jurisprudence led this court in *Curriculum Services* to make three main points:

> (i) First, the key principle that emerged from *Crystalline Investments* is that the disclaimer of a lease by the tenant's trustee benefits only the insolvent party: at para. 65.
>
> (ii) Second, while *Crystalline Investments* is consistent with the principle stated in *Re Mussens* that a disclaimer operates to end the bankrupt tenant's obligations under the lease, the decision does not support an interpretation of *Re Mussens* that would characterize a disclaimer as a consensual surrender for *all purposes*: at para. 65[.]
>
> (iii) Third, a trustee's disclaimer of a bankrupt tenant's lease ends the rights and remedies of the landlord *against the bankrupt tenant's estate* with respect to the unexpired term of the lease, apart from the three months' accelerated rent provided for under the *CTA* and *BIA*. This court stated, at para. 89:
>
> The Landlord's unsecured claim, however it is characterized, is precluded because the disclaimer brings to an end both the Tenant's ability to insist on performance of the Lease by the Landlord and the *Landlord's ability to claim in the Tenant's bankruptcy* in respect of any of its remedies.

(Emphasis added)

[63] *Curriculum Services* was concerned with the scope of a landlord's claim against the proceeds realized from the property of a bankrupt. By contrast, the issue in *Crystalline Investments* and *Cummer-Yonge* involved the effect of a trustee's disclaimer of a lease on the ability of a landlord to assert claims against third parties -- such as initial tenant assignors and guarantors -- for amounts due under the disclaimed lease. *Cummer-Yonge* had denied a landlord's claim against the guarantors of a bankrupt tenant's performance of all covenants under the lease because of the trustee's disclaimer. In *Crystalline Investments*, the Supreme Court overruled *Cummer-Yonge*, stating, at para. 42:

> 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.

[64] Left unexamined in *Crystalline Investments* was whether its reasoning about the survival of a landlord's claims against assignors and guarantors applied equally to claims by landlords on letters of credits issued by financial institutions at the instance of tenants. In the present case, the motion judge concluded, at para. 44, that *Crystalline Investment*'sreasoning did not apply to claims by a landlord under a letter of credit:

> In my view, Major J's comments [in *Crystalline Investments*] do not apply to BNS' obligations as the issuer of the [LOC] because its obligation to make payment to the Landlord under the [LOC] was wholly dependent on the continued existence of the [Tenant's] obligations to the Landlord under the Lease. *BNS had no independent obligation to make any payment to the Landlord pursuant to the [LOC] unlike an assignor or guarantor who has its own independent contractual obligations with a landlord to perform the tenant's obligations under the Lease*.

(Emphasis added)

[65] In my respectful view, the motion judge's conclusion was an error for two reasons.

[66] First, his decision runs counter to first principles. A basic principle applicable to standby letters of credit is that the issuing bank, such as BNS, has an independent obligation to make payment to the beneficiary. The relationship between the issuer (BNS) and the beneficiary (Landlord) is controlled by the principle of the independence or autonomy of standby letters of credit, not by the principles governing the claims that a landlord could make against the estate of a bankrupt tenant. Under the autonomy principle, the issuer must pay the beneficiary upon proper certification, subject to the limited exception for fraud: McGuinness, at §16.13. At paras. 48 to 58, above, I concluded that the conduct of the Landlord did not fall within the fraud exception so as to constrain the application of the autonomy principle to the Landlord's ability to draw on the LOC.

[67] Second, the motion judge's decision also runs counter to the weight of authority regarding the interplay between a trustee's disclaimer and a landlord's ability to draw on a letter of credit, especially the decision of this court in *Lava Systems Inc. (Receiver & Manager of) v. Clarica Life Insurance Co.* (2001), 31 C.B.R. (4th) 284 (Ont. S.C.), rev'd (2002), 161 O.A.C. 53 (C.A.), which I regard as the guiding authority.

[68] Counsel referred us to cases from Ontario and British Columbia that considered the effect of a trustee's disclaimer on a landlord's ability to draw on a letter of credit arranged by the

tenant. The cases pull in different directions, with several heavily influenced by principles enunciated in *Cummer-Yonge* that were later overruled in *Crystalline Investments*. All the cases pre-date the decision of the Supreme Court of Canada in *Crystalline Investments*.

[69] Two are decisions of this court: *Titan Warehouse Club Inc. (Trustee of) v. Glenview Corp.* (1988), 67 C.B.R. (N.S.) 204 (Ont. S.C.), aff'd (1989), 75 C.B.R. (N.S.) 206 (Ont. C.A.); and *Lava Systems*. One is a decision of the British Columbia Court of Appeal, *West Shore Ventures Ltd. v. K.P.N. Holding Ltd.*, 2001 BCCA 279, 88 B.C.L.R. (3d) 95, leave to appeal refused, [2001] S.C.C.A. No. 302. And two are decisions of judges of the Superior Court of Justice, both of whom became members of this court: *885676 Ontario Ltd. (Trustee of) v. Frasmet Holdings Ltd.* (1993), 17 C.B.R. (3d) 64 (Ont. Gen. Div.) (Blair J.); and *Peat Marwick Thorne Inc. v. Natco Trading Corp.* (1995), 22 O.R. (3d) 727 (Gen. Div.) (Feldman J.).

[70] I propose to review the decisions in chronological order: (i) *Titan Warehouse;* (ii) *Frasmet*; (iii) *Natco*; (iv) *West Shore* and (v) *Lava Systems*. As I will outline, *Titan Warehouse* and *West Shore* limited the scope of a landlord's ability to draw on a letter of credit to its statutory preferred claim. *Natco* did not involve a letter of credit, but in *obiter* comments supported that approach. By contrast, *Frasmet* and *Lava Systems* (at least in its result) recognized the landlord's right under the letter of credit to draw amounts beyond the statutory preferred claim. Once I have reviewed the jurisprudence, I will consider the impact of the decision in *Crystalline Investments* on this earlier jurisprudence and the present case.

Titan Warehouse (Court of Appeal, 1991)

[71] In *Titan Warehouse*, clause 22.00 of the lease required the tenant to provide the landlord with an irrevocable letter of credit on the following terms:

> [T]o *guarantee* to the Landlord the payment by the Tenant of the Rent and Additional Rent payable pursuant to this Lease during the first five (5) years of the Term. The said Letter of Credit shall be payable to the Landlord in the event of the bankruptcy of the Tenant ... and shall be payable upon the Landlord delivering to the issuing Bank or Financial Institution, a certificate signed by an officer of the Landlord, confirming that the Tenant is in arrears of payment of Rent and/or Additional Rent pursuant to this Lease[.]

(Emphasis added)

For any draw, the letter of credit required the landlord to provide a statutory declaration stating that it was "entitled to the amount drawn hereof in accordance with the terms of [the] Lease Agreement" between the tenant and the landlord.

[72] The tenant went into bankruptcy and the trustee disclaimed the lease. The trustee sought directions that the landlord was not entitled to draw on the letter of credit for any rent beyond the date of disclaimer. At first instance, at p. 208, the application judge allowed the trustee's application, holding as follows:

> In my view, the *Cummer-Yonge Investments Ltd., supra*, decision is dispositive of the application and the counter-application. The landlord is afforded protection by the letter of credit for any amount of rent owing up to the date of disclaimer but not thereafter.

[73] In a very brief endorsement, at pp. 206-7, this court affirmed the motion judge's ruling, stating:

> In our opinion, the letter of credit incorporated the terms of the lease by reference. Clause 22.00 thereof states that the letter of credit was *intended to guarantee* to the landlord payment of the rent by the tenant. In our view, the words making the letter of credit payable "in the event of the bankruptcy of the tenant", read in the context of the clause as a whole, must be related to the stated purpose of the letter of credit. In addition, the payment of the letter of credit cannot be obtained except upon proof that the tenant was in arrears of payment of rent, an event which was precluded by the disclaimer by the trustee.

(Emphasis added)

Frasmet Holdings (Gen. Div., 1993)

[74] *Frasmet Holdings* was a 1993 decision of Blair J. (as he then was). The tenant provided its landlord with an irrevocable letter of credit which, according to the lease, was "to secure the Tenant's obligations under this lease". Justice Blair found that the letter of credit was provided, in part, to secure the landlord's recovery of the cost of significant leasehold improvements. The tenant went into bankruptcy and the trustee disclaimed the lease. The landlord made a demand for payment under the letter of credit, and the trustee asked the court to restrain the payment.

[75] The trustee submitted that the principle in *Cummer-Yonge* was dispositive of a letter of credit situation involving a bankrupt tenant. Justice Blair disagreed, stating that

(i) *Cummer-Yonge* dealt with a guarantee, not a letter of credit. A fundamental difference exists between a letter of credit, which is a very specialized form of security, and a guarantee, which is not a form of security at all (except in a loose, non-legal sense of that term): at para. 27;

(ii) The decision in *Titan Warehouse* was distinguishable as it appeared to turn on the specific language of the letter of credit in that case, the purpose of which was "to guarantee to the landlord payment of the rent by the tenant". There is a "very material distinction" between a guarantee and a letter of credit: at paras. 29 and 39;

(iii) Letters of credit are a specialized form of commercial credit, designed by their very nature to be free and clear of the equities between the parties to the underlying transaction. They constitute an independent contract between the issuer and the beneficiary. This principle of "autonomy" goes to the root of the practice surrounding their issuance. The only admitted exception to the principle is fraud: at para. 30.

[76] Those distinctions led Blair J. to conclude, at para. 36, that since the stated purpose of the letter of credit was to secure the tenant's obligations under the lease and since bankruptcy is

a situation for which security is necessary, the landlord was entitled to draw on the letter of credit.

[77] Justice Blair further recognized, at para. 41, that while the bankruptcy of the tenant and the subsequent disclaimer of the lease by the trustee released the tenant and its trustee from the obligations under lease:

> [T]hey cannot, in my opinion, deprive the Landlord from having resort to the security for which it bargained in order to protect itself in the case of the very kind of eventuality which has occurred. Nor can they relieve the Bank of its obligation, under its contract with the beneficiary of the Letter of Credit, to pay upon being presented with the appropriate certificate[.]

[78] Later, in *Lava Systems*, this court referred with approval to Blair J.'s analysis of how an irrevocable letter of credit differs from a guarantee.

Natco (Gen. Div., 1995)

[79] In the present case, the motion judge noted that Blair J.'s reasoning in *Frasmet* was called into question by Feldman J. in *Natco*. However, several observations are in order about *Natco*. First, the case did not involve a letter of credit; it concerned a security interest taken by the landlord in the equipment of the tenant. Second, the reasons in *Natco* followed *Cummer-Yonge*'s holding regarding the unenforceability of a guarantee given by the tenant, a holding overturned in *Crystalline Investments*. Finally, Feldman J. acknowledged that since courts had recognized that in appropriately drafted leases the obligation of a guarantor could survive the termination of a lease following a tenant's bankruptcy, it followed that "a letter of credit or other security could be drafted to secure an obligation that survives the bankruptcy": at p. 732.

West Shore (B.C.C.A, 2001)

[80] The motion judge relied on the decision of the British Columbia Court of Appeal in *West Shore*, a case in which a majority of that court required a landlord to repay amounts drawn under a letter of credit arranged by its tenant. The letter of credit provided that draws could only be made when the beneficiary landlord made a demand accompanied by a certificate stating that the amount of the letter of credit was being drawn upon pursuant to clause 3A of the lease. That clause entitled the landlord to draw upon the letter of credit "for the full amount of monies represented thereby as prepaid rent and or fulfilment of the other obligations of the Lessee in respect of this lease, without limitation to any other rights or remedies of the Lessor at law or in equity if any one or more of the events as set out in clause 8.1(d), (e), (f), (g) or (h) should occur". Clause 8.1(f) provided that a default occurred under the lease if the tenant was declared bankrupt.

[81] The majority concluded that any losses suffered after the trustee's disclaimer could not be regarded as falling within the language of clause 3A of the lease: para. 33. The majority focused its analysis on how the lease expressed the obligations secured by the letter of credit stating, at para. 36:

> If the obligations secured are the obligations of the tenant under the lease then the security is no longer security for anything when the obligations of the tenant under the lease come to an end. *But where the obligations secured are obligations, perhaps independent obligations, to make good the losses suffered by the landlord by reason of the tenant's bankruptcy or other default, which might well include damages for loss of rent over the duration of the tenancy, then those separate obligations might well survive the bankruptcy of the tenant*.

(Emphasis added)

[82] Although the court ordered the landlord to repay the full amount of the letter of credit, it noted that its decision turned on the language of the lease and the letter of credit, stating, at para. 41: "We should add that a differently drawn lease and a differently drawn letter of credit could have produced a different result."

[83] I agree with the B.C. Court of Appeal that a landlord's entitlement to draw on a letter of credit in a given case will turn on the particular language of the lease and letter of credit. In the present case, the language of the Lease and LOC differs significantly from that at issue in *West Shore*. As noted, here the Lease specifically provides that the LOC acts as security for indemnification of the Landlord for losses "resulting from any termination, surrender, disclaimer or repudiation of this lease . . . in connection with any insolvency and bankruptcy or otherwise" and that the Landlord's rights in respect of the LOC were not affected by the disclaimer of the Lease in any bankruptcy proceeding but would "continue with respect to the periods prior thereto and thereafter as if the Lease had not been surrendered, disclaimed, repudiated or terminated". As well, the LOC expressly states that it will not be released, discharged or affected by the bankruptcy of the Tenant or the disclaimer of the Lease.

Lava Systems (Court of Appeal, 2002)

[84] The most recent decision of this court on the issue is that in *Lava Systems,* a decision referred to by the Trustee on the motion below[6] but not mentioned in the motion judge's reasons.

[85] In *Lava Systems*, the lease required the tenant to provide the landlord with an irrevocable letter of credit:

> [A]s security for the faithful performance by the Tenant of all the terms, covenants and conditions of this Lease for which the Tenant is responsible. The Landlord may draw upon the Letter of Credit in whole or in part as may be necessary to compensate the Landlord for any loss or damage sustained due to the Tenant's breach of its obligations under this Lease.

[86] To draw on the letter of credit, the landlord was required to provide the issuer with a statement that "the amount drawn is in connection with the indebtedness of [the tenant] with respect to the demised premises". The letter of credit also stated that it would "survive the termination, repudiation, surrender and/or discharge of the Lease . . . but within the validity of this Credit".

[87] A private receiver was appointed over the tenant. At that point, the landlord drew the full amount of the letter of credit to cover future rent and the cost of tenant inducements. The tenant

then went into bankruptcy and the trustee disclaimed the lease. The trustee took the position that the landlord was only entitled to draw on the letter of credit for the amount of the landlord's preferred claim under *BIA* s. 136(1) (*f*). The trustee applied for directions, including the return by the landlord of any excess draw.

[88] The application judge ordered the landlord to return the excess amount drawn. Following the decisions in *Cummer-Yonge*, *Titan Warehouse*, and *Natco*, the application judge held that the only right of the landlord which survived the termination of the lease was the preferential lien under *BIA* s. 136(1)(*f*).

[89] This court allowed the landlord's appeal. It identified two issues on the appeal:

(i) As the funds drawn on the letter of credit by the landlord were the property of the bank and not of the bankrupt tenant, did the tenant or its receiver and manager have a legal right to recover any funds that the landlord may have improperly claimed and been paid under the letter of credit?

(ii) Did the application judge err in holding that the landlord's draw on the letter of credit was limited to its statutory entitlement?

This court decided the first issue in favour of the landlord; it did not address the second issue.

[90] As to the first issue, this court held that the tenant's receiver-manager did not have a legal right to recover draws made by the landlord on the letter of credit. The court reached this conclusion on the basis of the autonomy of letters of credit, stating, at para. 5:

> On the basis of these principles, whether [the landlord] was entitled to draw on the letter of credit, and, if so, in what amount, is a matter between it and the bank that issued the letter of credit. In making payment pursuant to [the landlord's] demand, the bank adhered to its obligations under the letter of credit. The funds which it paid to [the landlord] were its property, not that of [the tenant]. Had [the landlord] not drawn on the letter of credit, the balance remaining available to [the landlord] under the letter of credit would continue to be the property of the bank. In such circumstances, neither [the tenant's] receiver and manager, nor its trustee in bankruptcy, would have any claim on the undrawn portion of the security represented by the letter of credit. In my view, the fact that [the landlord] had obtained these funds as a result of its demand under the letter of credit places [the trustee/receiver] in no better position than it would have been in had [the landlord] not issued its demand. This is because the funds available as security under the letter of credit at all times were the property of the bank.

[91] However, the court stated, at para. 9, that there are two situations in which a trustee might have a legal right to obtain redress against a beneficiary landlord who drew on a letter of credit:

(a) If the bank had assigned to the receiver any claim that it had against the landlord: "To succeed, the bank or the receiver as assignee of the bank's interest, would have to prove

> that [the landlord] acted fraudulently as that is the only basis on which an issuer of a letter of credit can obtain redress from the beneficiary"; or
>
> (b) If the tenant had reimbursed the bank for the amount drawn by the landlord on the letter of credit, the tenant, or its receiver, might have a claim against the landlord for breach of a clause in the lease that the landlord would hold the proceeds from any draw as security for the performance by the tenant of obligations under the lease.

[92] This court concluded that, since the record in *Lava Systems* did not contain evidence of either situation and there was no finding of fraud against the landlord, the receiver had no right to recover draws made by the landlord on the letter of credit.

[93] Of the two cases decided by this court -- *Titan Warehouse* (1989) and *Lava Systems* (2002) -- I regard the reasoning in *Lava Systems* as the more persuasive for two reasons.

[94] First, the decision in *Lava Systems* addressed the principle of the autonomy of documentary letters of credit, whereas that in *Titan Warehouse* did not deal with the principle. *Lava Systems* referred, with approval, to the extensive analysis of Blair J. in *Frasmet* explaining how an irrevocable letter of credit differs from a guarantee. The portion of *Frasmet*'s reasons cited with approval by this court included the following statement by Blair J., at para. 36:

> It can scarcely be gainsaid that an event which is sure to impair a tenant's ability to honour its obligations under the lease is its bankruptcy. Why should [the landlord], which had obtained for itself a stand-by letter of credit as collateral security in connection with the lease transaction, be precluded from calling upon that security when the very kind of situation for which security is most likely necessary arises? In my view, in the circumstances of this case, it should not be so precluded.

[95] Lazar Sarna, in *Letters of Credit: The Law and Current Practice,* looseleaf (2020-4), 3rd ed. (Toronto: Carswell, 2019), at p. 5-39, echoes the comments of Blair J.:

> It is widely assumed, with ample justification, that the right of the beneficiary to obtain payment upon the letter of credit from the issuer is in no way affected by the insolvency or bankruptcy of the applicant. Indeed, one of the fundamental commercial reasons for the use of the letter of credit mechanism is to secure anticipated payments in a manner which would not rely upon the will, status or financial faith of the applicant.

See, also, David Bish, *Canadian Bankruptcy and Insolvency Law for Commercial Tenancies* (Toronto: LexisNexis, 2016), at p. 248.

[96] Second, the brief decision in *Titan Warehouse* regarded the language in the letter of credit that stated it was "intended to guarantee to the landlord payment of the rent by the tenant" as subject to *Cummer-Yonge's* treatment of guarantors of leases in bankruptcies. However, that aspect of *Cummer-Yonge* was overturned by the Supreme Court in *Crystalline Investments* and is no longer good law.[7]

[97] I turn now to the application of *Lava Systems* in the context of this case.

B. *The Application of Lava Systems*

[98] *Lava Systems* applied the principle of the autonomy of letters of credit, although it recognized two exceptions to that principle. Neither applies in the present case.

[99] The first exception would arise if BNS had assigned to the Trustee any claim it had against the Landlord. The Trustee, as assignee, would have to prove that the Landlord acted fraudulently in drawing on the LOC.

[100] BNS made no such assignment but, in any event, the Trustee's repeated submissions that the Landlord's draws were "improper" simply bring the analysis back around to the question of whether the Landlord's draws under the LOC fell within the fraud exception to the autonomy principle. For the reasons set out in paras. 48 to 58, above, I have concluded that on this record the Landlord's conduct in drawing on the LOC did not fall within the fraud exception to the autonomy principle.

[101] According to *Lava Systems*, the second situation in which the Trustee might be entitled to redress from the Landlord for draws made on the LOC would be if the Tenant had reimbursed BNS for the amount of any "improper" draw by the Landlord on the LOC.

[102] In *Lava Systems*, this court stated, at para. 9, that if the tenant in that case had reimbursed the bank for the amount drawn by the landlord, the tenant or its receiver might have a claim against the landlord for breach of clause 26.01(b) of the lease for the amount of the improper draw. Clause 26.01(b) of the lease provided that if the landlord drew down on the letter of credit, it would hold the proceeds as security for the performance by the tenant of its obligations under the lease.

[103] The Trustee relies on this portion of the decision in *Lava Systems* to submit that where a bank reimburses itself from the tenant's property as a result of an improper draw by a landlord on a letter of credit, a trustee may have recourse against the landlord if the draws were improper. As the Trustee notes, in the present case the Landlord's draws on the LOC diminished the amount of the GIC held by BNS as security, which otherwise would have been available for distribution to the Tenant's creditors.

[104] I do not accept this submission by the Trustee for three reasons.

[105] First, the comments in *Lava Systems* about the effect of a right of reimbursement from the bankrupt tenant's estate were anchored in the specific language of the lease in that case, namely, clause 26.01(b). The Trustee's attempt to stretch that case-specific lease language into a principle about the effect of any right by an issuer to seek reimbursement from the bankrupt's estate must now be read in light of the decision in *Crystalline Investments*. In that case, the Supreme Court rejected the argument that the existence of a right of indemnification for an initial tenant assignor or guarantor against a bankrupt tenant would frustrate the objectives of the *BIA* or was a good reason to regard a trustee's disclaimer of a lease as its termination for all purposes: at paras. 32-33. The Supreme Court observed that *BIA* s. 179 conserved the liabilities of alternative debtors.[8] Further, Major J. stated, at para. 35:

> [W]here an original tenant seeks indemnification on a contingent claim, provided the claim is provable and not disallowed, it would fall into the insolvency to be dealt with in accordance with the scheme of the Act. The assignor simply joins the other unsecured creditors in the

proceedings. If such a claim is approved, it cannot satisfy and at the same time frustrate the Act.

[106] As this court noted in *Lava Systems*, at para. 5, under the law concerning standby letters of credit the funds an issuing bank pays to a beneficiary are the property of the bank, not the applicant customer: see also McGuinness, at §16.54.[9] Although an issuing bank does not have a right of subrogation against its applicant customer in the event it is called upon to pay under a letter of credit, its contract with the customer applicant may include a right to reimbursement: *Westpac Banking Corp. v. Duke Group Ltd.* (1994), 20 O.R. (3d) 515 (Gen. Div.), at pp. 530-39; McGuinness, at §17.92; Sarna, at p. 8-43. Where such a contractual right of reimbursement exists, a bank may seek reimbursement for any amounts it is required to pay out under a letter of credit. In this respect, a contractual claim for reimbursement brought by an issuing bank would have the same economic effect on a bankrupt tenant's estate as a claim for indemnification brought by an original tenant assignor or guarantor. Applying the reasoning of *Crystalline Investments*, the existence of such a contractual right to reimbursement by an issuing bank would not frustrate the objectives of the *BIA* or justify treating a trustee's disclaimer of a lease as its termination for all purposes.

[107] The second reason is a factual one. As noted above, in para. 10, BNS held cash collateral security in the form of a GIC from the Tenant in support of the LOC and BNS had registered a *PPSA* financing statement against the Tenant. The bank's realization on its security following its payments of draws by the Landlord no doubt reduced the amount available for distribution to the Tenant's unsecured creditors. However, the scheme of distribution set out in *BIA* s. 136 recognizes that the amount available for distribution to unsecured creditors is "subject to the rights of secured creditors".[10] In the present case, the Trustee has not disputed the validity of the BNS security.

[108] The final reason lies in the provisions of the *BIA* or, more specifically, in what the *BIA* does not contain. To accept the Trustee's position would, in effect, be tantamount to accepting the proposition that the *BIA* does not permit a landlord to take security from its tenant, through the vehicle of a letter of credit, that would exceed the amount of a claim for accelerated rent under *BIA* s. 136(1)(*f*). Yet, the *BIA* does not contain any such language of limitation or prohibition. Whether the *BIA* should contain such a limitation is a matter for Parliament to consider.[11] As part of any such consideration, Parliament no doubt would have to weigh the costs of eroding the principle of autonomy of standby letters of credit against any benefits arising from the limitation advocated by the Trustee.

C. *Conclusion on Issue 1*

[109] For these reasons, I conclude that the motion judge erred in limiting the Landlord's entitlement to draw on the LOC to its preferred claim under *BIA* s. 136(1)(*f*) for three months' accelerated rent. BNS accepted the Landlord's draws on the LOC as complying presentations. The Trustee has not established that the Landlord's conduct in drawing on the LOC, when assessed in light of the language of s. 2(a) of Schedule C to the Lease and of the LOC, fell within the fraud exception to the principle of the autonomy of letters of credit. Finally, I see no provision in the *BIA* or principle of Canadian bankruptcy law that overrides the autonomy principle and precluded the Landlord from drawing on the LOC for amounts in excess of its

preferred claim against the bankrupt's estate for three months' accelerated rent. Consequently, I conclude that the Landlord was entitled to draw up to the full amount available under the LOC.

[110] Next, I consider whether the amount available was the face amount of $2.5 million or a reduced amount of $1,357,135.53.

VII. ISSUE 2: DID THE TERMS OF THE LEASE MANDATE A REDUCTION IN THE VALUE OF THE LOC ON MAY 1, 2017?

A. *The Issue Stated*

[111] As an alternative submission on the motion below, the Trustee argued that the language of the LOC mandated a reduction in its value on May 1, 2017 to $1.357,135.53. The motion judge accepted that argument. The Landlord submits that the motion judge erred in that conclusion. I agree that the motion judge erred in his interpretation of the Lease. As I will explain, his interpretation of the Lease's LOC reduction clause was based on an error concerning an extricable question of law.

B. *The Provisions of the Lease*

[112] Section 2(a) of Schedule C to the Lease contains a provision concerning reductions in the value of the LOC during the term of the Lease. For the value to be reduced, the Tenant must never have been in default and must have "promptly" paid all rent:

> If Tenant is not then and has not been in default of its obligations under this Lease and *has at all times promptly paid all Rent throughout the Term*, the [LOC] *shall* decline in value as set out in subparagraph (b) below (the value of the [LOC] from time to time being hereinafter referred to as the "Principal Amount").

(Emphasis added)

[113] Section 2(*b*) sets out the mechanism by which the amount of the LOC could be reduced during the term of the Lease:

> *If Tenant is not then and has not been in default of its obligations under this Lease and has at all times promptly paid all Rent throughout the Term, this Lease has not been disclaimed*, and at no time has Landlord been required to draw upon the [LOC] (failing any such pre-conditions, this subparagraph (b) shall cease to have application), the [LOC] *may* be reduced as follows:
>
> (i) on the thirty-seventh (37th) month of the initial Term, the [LOC] *may* be reduced by an amount equal to fifty percent (50%) of the Permitted Decline Amount (as herein defined)

. . . . .

> For the purposes of this Paragraph 2(b) of Schedule C, "Permitted Decline Amount" means a sum equal to (I) [$2.5 million]; less (II) an amount equal to the Annual Rent, the estimated Operating Costs and taxes, and HST thereon, payable by Tenant for the last month of the initial Term.

(Emphasis added)

[114] The language in s. 2(*a*) differs from that in s. 2(*b*). The former states that if certain conditions are met, the LOC "shall decline in value as set out in subparagraph (b)"; whereas subparagraph (b) states the LOC "may be reduced" in value. However, that difference does not play a role in the determination of this issue, which turns on whether the motion judge erred in finding that the Tenant had satisfied the pre-conditions for a reduction in the value of the LOC.[12]

[115] The 37th month of the initial term referred to in s. 2(b) commenced on May 1, 2017. No reduction in the amount of the LOC was requested or made at that time. As a result, the amount of the LOC at the time of the Tenant's bankruptcy remained at $2.5 million and that was the amount the Landlord drew down.

C. *The Reasons of the Motion Judge*

[116] The motion judge accepted the Trustee's submission that the language of the LOC mandated a reduction in its value on May 1, 2017, and so, even if the Landlord was entitled to draw on the LOC for amounts in excess of its statutory preferred claim for three months' accelerated rent, the draws could not exceed $1,357,135.53.

[117] At paras. 48 to 51 of his reasons, the motion judge stated:

> The terms of the Lease clearly require the [LOC] to be reduced to $1,357,135.53 as of May 1, 2017 if there have been no events of default under the Lease and the [Tenant] has paid rent promptly. I find that the language used in the Lease makes this reduction in value of the [LOC] mandatory if these conditions are met.
>
> There were no events of default under the Lease before the bankruptcy and the delays by the [Tenant] in paying rent were relatively minor. Further, the Landlord never advised the [Tenant] that it had failed to pay rent promptly under the terms of the Lease.
>
> In my view, the term "promptly" means within a reasonable time and not on the actual date that the rent is due. I find that the [Tenant] paid its rent within a reasonable time.
> For these reasons I have concluded that the value of the [LOC] was reduced to $1,357,135.53 as of May 1, 2017.

D. *Analysis*

[118] Although the decision of the Supreme Court of Canada in *Sattva Capital Corp. v. Creston Moly Corp.*, [2014] 2 S.C.R. 633, 2014 SCC 53 teaches, at paras. 52-54, that appellate courts should give deference to first instance decision-makers on points of contractual interpretation, deference does not apply when the interpretation is marked by an error on an extricable question of law. In my respectful view, the motion judge's interpretation of the Lease's LOC reduction clause was based on an error concerning an extricable question of law.

[119] The error concerns the motion judge's interpretation of the word "promptly" in ss. 2(a) and (b) of Schedule C to the Lease. Any decline in value of the LOC during the term of the Lease required that the Tenant had "at all times promptly paid all Rent through the Term". The motion judge interpreted the word "promptly" to mean "within a reasonable time and not on the actual date that the rent is due".

[120] Legal errors made in the course of contractual interpretation include the failure to consider a required element of a legal test: *Sattva*, at para. 53. A fundamental legal precept of contractual interpretation requires an examination of the contract as a whole, not just a consideration of the specific words in dispute. Individual words and phrases must be read in the context of the entire document: Geoff R. Hall, *Canadian Contractual Interpretation Law*, 3rd ed. (Toronto: LexisNexis, 2016), at p. 16.

[121] In his reasons, the motion judge did not take into account several provisions of the Lease that are relevant to the interpretation of the word "promptly" in ss. 2(a) and (b) of Schedule C. First, s. 1.01 of the Lease provides that the Tenant was to pay the Annual Rent in equal monthly amounts "payable . . . on the first day of each calendar month during the Term". No provision of the Lease exempted statutory holidays from this requirement. No provision qualified this obligation to permit the Tenant to pay rent within a "reasonable time" of the first day of each calendar month.

[122] Second, s. 15.03(a) of the Lease provides that the failure to pay rent when due constitutes a default: when "the Rent hereby reserved is not paid in full when due, and *such default* continues for five (5) days after written notice . . ." (emphasis added). A default therefore occurs if rent is not paid when due, namely, on the first day of each calendar month.

[123] Third, s. 16.08 states that "[n]o provision of this Lease shall be deemed to have been waived by Landlord or Tenant unless such waiver is in writing signed by the other". There was no evidence that the Landlord had waived in writing the Tenant's obligation to pay rent on the first day of each calendar month.

[124] Taken together, these three provisions do not support the motion judge's interpretation that the word "promptly" in s. 2(a) and (b) of Schedule C of the Lease means within a reasonable time and not on the actual date the rent is due. Yet, these three provisions did not form part of the motion judge's analysis.

[125] One purpose of the LOC was to provide the Landlord with security that the Tenant would perform its obligations under a long-term lease, one of which was the payment of rent. Reducing the value of the LOC would decrease the protection enjoyed by the Landlord against the Tenant's default. No doubt that is why s. 2(a) and (b) use "tight" language when setting the pre-conditions for a reduction in the value of the LOC: a reduction in the value did not depend upon the absence of an "event of default"[13] but on the Tenant paying rent "promptly" "at all times". The failure to pay rent on the date due would put the Tenant in default (although not an "event of default"). When considered in that context and in light of the whole Lease, "promptly" means payment of rent when due -- namely, on the first day of each calendar month.

[126] This interpretation finds further support in s. 3.03 of the Lease, which stipulates "[a]t Landlord's request, Tenant will make all payments under this Lease by way of electronic funds transfer from Tenant's bank account". Electronic fund transfers eliminate the problem associated

with the physical delivery of a rent cheque, such as when the due date falls on a statutory holiday. The evidence of Alistair Pickering, a representative of the Landlord, was that it would have requested a move to electronic funds transfer as a normal course of action.

[127] There was no dispute that prior to May 1, 2017 the Tenant had twice failed to pay rent when due on the first day of each calendar month: the rent payments due February 1, 2015 and July 1, 2015.[14] Consequently, there were two occasions prior to May 1, 2017 when the Tenant had failed to pay rent "promptly" for the purposes of ss. 2(a) and (b) of Schedule C to the Lease. Due to those failures, the Tenant had not satisfied the pre-conditions for a reduction in the value of the LOC on May 1, 2017. The motion judge erred in finding otherwise.

VIII. DISPOSITION

[128] For the reasons set out above, I would allow the appeal, set aside the order of the motion judge, and dismiss the Trustee's motion.

[129] The Landlord is entitled to its costs of the appeal and its costs below. If the parties are unable to agree on those amounts, they shall file written submissions not exceeding three pages in length, together with bills of costs, within ten days following the release of these reasons.

Notes

1 A trustee in bankruptcy has the power to disclaim any lease of the bankrupt's property: Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 30(1)(k); Commercial Tenancies Act, R.S.O. 1990, c. L.7, s. 39(1).

2 BIA s. 136(1)(f) states:

> 136(1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:
>
> . . . . .
>
> (f) the lessor for arrears of rent for a period of three months immediately preceding the bankruptcy and accelerated rent for a period not exceeding three months following the bankruptcy if entitled to accelerated rent under the lease, but the total amount so payable shall not exceed the realization from the property on the premises under lease, and any payment made on account of accelerated rent shall be credited against the amount payable by the trustee for occupation rent.

3 Article 2 of the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600, defines a "complying presentation" as a "a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice".

4 Section 3 in Schedule C of the Lease defined the Landlord's Work, which consisted of a number of pre-occupancy improvements to the Premises by the Landlord. The hard and soft costs of the Landlord's Work were capped at $500,000. Upon default under the Lease, the Tenant was required to pay the Landlord the unamortized cost of the Landlord's Work.

5 The language found in the Lease and LOC reflects, to an extent, the advice found in the professional insolvency commentary on drafting letters of credit. The commentary suggests how a landlord can draft a letter of credit so that its ability to make draws is not limited to its preferred claim under BIA s. 136(1)(f) in the event of its tenant's bankruptcy and the trustee's disclaimer of the lease. Some commentators have offered that a landlord could draft the lease and

letter of credit to provide that its ability to draw on the letter of credit does not depend on the continuing obligations of the tenant under the lease. Instead, the lease and letter of credit could provide that the letter of credit is security for damages or loss suffered by the landlord as a result of a breach or termination of the lease: Clive S. Bird and Kendall E. Andersen, "Various Landlord Issues in British Columbia Insolvencies" (2003) Insolvency Institute of Canada Article 2003-10, at p. 3; Darrell M. Gold, "Letters of Credit, Tenant Bankruptcy and Lease Disclaimers - Is Your LC Worth the Paper It's Written On?" (9 January 2020), online: Robins Appleby LLP: https://www.robinsappleby.com/resources/ in-the-media/details/ 2020/01/09/letters-of-credit-tenant-bankruptcy-and-lease-disclaimers-is-your-lc-worth-the-paper-it-s-written-on.

6 Factum of the Fuller Landau Group Inc., Trustee in Bankruptcy, dated June 4, 2019, at paras. 58-60; Reply Factum of the Fuller Landau Group Inc., Trustee in Bankruptcy, dated June 28, 2019, at para. 4.

7 The same is true of the obiter comments in Natco that called into question the analysis of Blair J. in Frasmet. The comments in Natco also relied on Cummer-Yonge's treatment of guarantors that was overturned in Crystalline Investments.

8 BIA s. 179 states: "An order of discharge does not release a person who at the time of the bankruptcy was a partner or co-trustee with the bankrupt or was jointly bound or had made a joint contract with the bankrupt, or a person who was surety or in the nature of a surety for the bankrupt."

9 As a result, a bank pays a beneficiary with its own funds, not those of the applicant customer: Sarna, at pp. 5-29 & 5-39.

10 As the Supreme Court of Canada recently held in Chandos Construction Ltd. v. Deloitte Restructuring Inc., 2020 SCC 25, at para. 40, the anti-deprivation rule is not offended when commercial parties protect themselves against a contracting counterparty's insolvency by taking security, acquiring insurance, or requiring a third-party guarantee.

11 The case law's lack of clarity about the ability of a landlord to draw on a letter of credit following a trustee's disclaimer of the lease has led commentators to suggest some convoluted solutions. For example, building on Crystalline Investments, some commentators suggest that a landlord could require a third party, such as a guarantor or indemnifier, to arrange for the letter of credit, instead of the tenant: Norton Rose Fulbright, "Tenant Insolvency Issues for Commercial Landlords in Alberta" (28 May 2020) online: ww.nortonrosefulbright.com/en-ca/knowledge/publications/d3d54f6a/ tenant-insolv Steven Jeffrey, "Cummer-Yonge - a Post-Mortem: Crystalline Investments Ltd. v. Domgroup Ltd." (2006), 21 Banking & Finance L.R. 263, at p. 300.

12 In its factum, the Trustee argues that the reduction in the value of the LOC was mandatory and not conditional on any request by the Tenant to the Landlord for a reduction. However, by its terms the LOC was "irrevocable" and for the amount of $2.5 million. A credit cannot be amended without the agreement of the issuing bank and the beneficiary: UCP 600, art. 10(a); McGuinness, at §17.149. Consequently, whatever view one takes of the differing "shall" and "may" language in ss. 2(a) and (b) of the Lease, any reduction by the issuer BNS in the amount of the LOC would require either the agreement of the Landlord or a court order directing the amendment by reason of the Landlord's breach of a requirement in the Lease that it agree to a reduction.

13 Section 15.03(a) of the Lease provides that an event of default occurs if "the Rent hereby reserved is not paid in full when due, and such default continues for five (5) days after written notice".

14 The Landlord had to follow up with the Tenant on February 3, 2015 to request payment of the February rent.

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