

How to Advise Your Client When: It is Faced with a Repudiation

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Rescission and repudiation are often confused. The distinction between the two is highlighted in the recent Ontario Court of Appeal decision of *TNG Acquisition*.¹ According to Gillese, JA., who wrote the decision for the Court of Appeal, rescission is a remedy that may be available to an innocent party to a contract in certain circumstances. Rescission allows that innocent party to treat the contract as being void, ab initio. Repudiation, on the other hand, occurs by the words or conduct of one party to a contract that shows an intention NOT to be bound by that contract.

Put another way, rescission is a reaction - it is a remedy that an innocent party to a contract may have that results from the acts or omissions of the other party. While repudiation, on the other hand, is an action by one party to a contract who no longer wishes to be bound by that contract.

By way of example, when an innocent party to a contract discovers that he or she was induced to enter into the contract by reason of fraud or essential error of a material kind (or by certain false or misleading misrepresentations), the innocent party may rescind, or terminate, the contract.² If the contract is rescinded, the innocent party is expressing his or her refusal to be bound by such contract. The rescinded contract becomes void ab initio and the parties to the rescinded contract should be put back into the position in which they stood before the contract was entered into.

¹ *TNG Acquisition Inc. (Re)*, 2011 ONCA 535 (CanLii) at para. 25.

² *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423; 1999 CarswellOnt 3171 at para. 39.

Repudiation, on the other hand, occurs by words or conduct evidencing an intention NOT to be bound by a contract or that the repudiating party will not fulfill any future obligations under the contract.³

According to Fridman in *The Law of Contract in Canada*, the effect of a repudiation depends on the election made by the non-repudiating party. The non-repudiating party may ignore or refuse to accept the repudiation. The contract will then remain in effect. Or, the non-repudiating party may accept the repudiation. And if the repudiation is accepted, the contract is then terminated and brought to an end.⁴

According to Wilson, J. in *Keneric Tractor Sales Ltd. v. Langille*,⁵ an accepted repudiation does not result in the contract being rescinded. Repudiation terminates a contract from the time that the repudiation is accepted, but does not result in the contract being void ab initio. The innocent party is entitled to damages suffered as a result of the repudiation.

The recent Court of Appeal decision of *TNG Acquisition*⁶ is an interesting example of just how important it is for an innocent party faced with a repudiation to deal with the repudiation. In this case, a tenant of commercial space obtained a CCAA order giving it the right to terminate or to repudiate any lease. This tenant then sent a letter to its landlord advising its landlord that the tenant was repudiating the lease. The landlord failed to respond. It neither accepted nor rejected the repudiation. Ultimately, the CCAA restructuring plan was never completed and shortly thereafter, the tenant went bankrupt. The trustee in bankruptcy disclaimed the lease as permitted in the *Bankruptcy and Insolvency Act*.⁷

The landlord argued before the Court of Appeal that when it received the repudiation letter, the lease was terminated and the landlord then had a \$3,300,000 claim against the tenant for breach of the lease. The landlord argued that its \$3,300,000 claim should be allowed by the trustee in bankruptcy, and that the trustee should not have disclaimed its lease. The Court of Appeal was unanimous. The Court of Appeal

³ *Supra* 2 at para. 40.

⁴ Gerald H.L. Fridman, *The Law of Contract in Canada*, 4th ed. (Scarborough: Carswell, 1999) at 651-652.

⁵ *Keneric Tractor Sales Ltd. v. Langille*, [1987] 2 S.C.R. 440 at page 455.

⁶ *Supra* 1

⁷ RSC 1985, c B-3

held that the repudiation letter sent by the tenant did not end the lease, because repudiation and termination are not the same thing. The repudiation letter gave the landlord a choice - to either refuse the repudiation and keep the lease alive, or to accept the repudiation, which would have ended the lease but left a cause of action available to the landlord for damages for breach of the lease. Because the landlord did nothing, or more importantly, because the landlord did not accept the repudiation, the Court of Appeal concluded that the landlord was deemed to have rejected the repudiation and the lease remained in full force and effect. It then followed that there was never a cause of action that flowed to the landlord before the bankruptcy. The trustee therefore had the right to disclaim the lease and the landlord could only file a preferred claim in bankruptcy for three month's rent, or about \$100,000 (rather than the \$3,300,000 of damages that the landlord would have been entitled to claim had the landlord accepted the repudiation). Clearly, the difference was dramatic.

The unanimous Supreme Court of Canada decision in *Highway Properties v. Kelly, Douglas & Co.*⁸ looked at the damages available to a landlord, following a tenant's repudiation of its lease. Laskin, J, speaking for the Court, concluded that the damages available to a landlord following the tenant's repudiation of a commercial lease should be the same as the damages available to an innocent party following the repudiation of a commercial contract. But Laskin, J. made it clear that the landlord, when faced with a repudiation by its tenant, had to choose whether to accept the repudiation and terminate the lease, or to reject the repudiation altogether and keep the lease alive.

The distinction, therefore, between rescission and repudiation is clearly an important one. And the choices that an innocent party is faced with, when the other party repudiates a contract or a lease, are key to protecting and preserving the innocent party's rights, remedies, and quantum of damages.

⁸[1971] S.C.R. 562.