

**ICSC CANADIAN LAW CONFERENCE - APRIL 21, 2016**

**INDEPTH WORKSHOP ON PERMITTED ASSIGNMENT AND TRANSFER  
PROVISIONS**

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This is a background paper for the Workshop noted above. Its purpose is to provide information relevant to the landlord's desire to keep the tenant and its extended family relationships as they were the day the lease agreement was entered into and, the tenant's desire to allow it to change and to deal with the lease, particularly within the network of parties related to it.

**The Basic Concerns**

Commercial leases contain restrictions on assignment, subleasing and parting with or the sharing of possession and control. Those types of transactions are referred to in this paper as "Direct Transfers". The restrictions reflect two basic concerns: (i) concern about the quality of operation of the tenant's business in the premises, its ability to generate revenue, and the character of the tenant having regard to the financial strength as well the operating and business practices of the tenant, and (ii) the concern with ensuring that market rental value increases accrue to the landlord's benefit (and not the tenant's).

The tenant in a commercial lease may be an individual, a corporation, a general partnership, a limited partnership, a trust, a joint venture, a club, an association or a combination of those entities. The protection afforded by restricting a tenant's right to effect a Direct Transfer can be deteriorated by a variety of transactions that result in changes of control of the tenant (and thus the premises) by indirect means. For that reason, changes of control of the tenant are usually restricted. The mechanism for change in control will vary depending on the nature of the tenant. This workshop will look at those situations that should be considered as changes of control of the tenant in respect of which a landlord would want to have a right of prior approval. This involves understanding the manner in which control is exercised and how it might change for each of those entities. We will also examine those situations where a Direct Transfer might be permitted on the basis that the control of the tenant does not change, or, on the basis that a change of

control either does not have an adverse effect or, on the basis that it is simply not practical or feasible to enforce a right of prior approval.

### **The Initial Question – Who is the Tenant?**

It is important to first determine who the tenant is for the purposes of deciding what entity the change of control restrictions should apply to. Alternatives include:

1. the original tenant that signs the lease.
2. the tenant in possession of the premises pursuant either the initial lease or an assignment of the lease.
3. an entity that acquires the tenancy by a Direct Transfer from the original tenant but subsequently transfers it, and
4. an indemnifier who agrees to be bound by the lease as though it were the tenant.

There are important implications attached to this question. For example, if a corporation makes a Direct Transfer to a new tenant and, subsequently, after the new tenant is in possession of the premises and carrying on business, effects a change of control, should that have any bearing on a lease which contains a restriction against a change of control of the tenant? If the definition of “tenant” for this purpose is not clear, a change of control of the tenant might result in an inadvertent default under the lease. On the other hand, when a tenant assigns a lease the landlord’s willingness to consent to the assignment may in fact be affected by the fact that the original tenant continues to be bound by the lease. If as a result of a change of control the original tenant is weakened financially, the landlord may have a legitimate concern.

A typical default clause in a commercial lease will also treat bankruptcy, insolvency and a number of other acts or omissions on the part of the tenant as an event of default. If the original tenant becomes bankrupt or winds up its corporate undertaking should that be treated as a default on the part of the new tenant in possession of the premises after an assignment of the lease assuming that the assignee continues to be financially viable?

Similar concerns are related to the situation where the lease is buttressed by means of an indemnity agreement (a form of guarantee) by a third party. Typical indemnity agreements require the indemnifier to agree to be bound by the lease in the same way as the tenant and, it is not unusual for the indemnifier to actually sign the lease to confirm its obligations. Default articles will often treat a default by an indemnifier of its obligations under the lease or an indemnity agreement as a default under the lease. Accordingly, the change of control of an indemnifier might be treated as a transaction in respect of which the landlord’s consent is required.

From a tenant's perspective it is of course desirable to avoid or limit clauses relating to changes of control and defaults to the actions of the tenant then in possession.

## **Triggering Events**

To determine what transactions should amount to a change of control, it is necessary to understand the nature of the tenant in each case. As mentioned above, the tenant might be an individual, a corporation, a partnership, a limited partnership, a trust or joint venture or some other type of entity such as a club or association. The Tenant might also be comprised of a combination of those entities. Following is a discussion of the kinds of transactions that might be considered as a "change of control" in respect of which the landlord's consent is required and which relate specifically to each of the types of entities noted above.

## **The Individual**

At first blush it seems a little odd to consider a change of control of the tenant as a factor to be considered in determining whether the landlord's consent is required because, the individual in each instance is the decision making agent in relation to the lease. However, there are situations where indirect control of the individual can be transferred or restricted even while the tenant continues to be the tenant in possession and has not made a Direct Transfer. For example, an individual may make a declaration of trust in which the individual agrees to hold its interest in the lease in trust for a beneficiary. Depending on the purpose of the trust and the nature of the beneficiary, the individual's ability to deal with the lease and to carry on business on the premises might be dramatically impeded. Another example is the entering into of a partnership agreement by an individual where the individual agrees in the partnership agreement to treat the lease as partnership property. In that situation even if the individual continues to be the sole occupant to the premises, its activities in the premises and its dealings with the premises might be affected by the partnership interests. Similarly, an individual might enter into a joint venture agreement in which it agrees that the leased premises will be held or operated according to particular arrangements that are set out in the joint venture agreement. An individual might also enter into an equitable mortgage or pledge arrangement, or a loan agreement in which, although it continues to hold title to the lease and does not actually convey or legally change its interest, it agrees to restrict its activities in the premises or its use of the lease in accordance with requirements and restrictions set out in a loan agreement.

In practical terms although situations such as those described above can in fact have a legal and practical effect on the tenant and the lease, it is unusual to find restrictions dealing with these kinds of situations in relation to a particular individual within a lease.

## **Corporations**

There are a number of types of transactions that require consideration in connection with corporations that need to be considered. For example:

1. a simple share transfer;
2. a change in the control of the controlling shareholder. The controlling shareholder might be an individual, another corporation (a parent company), a partnership, a trust, a joint venture or a combination of those entities;
3. corporate arrangements such as transactions contemplated by Section 192 of the *Canada Business Corporations Act* and similar statutes. These would include an amalgamation, a merger or restructuring and might also include a reorganization as contemplated by Section 191 of that Act;
4. a consolidation in which the assets of two or more corporations are transferred to a single corporation and the consolidating corporations are wound up;
5. a mortgage or pledge of the shares of the corporation which might include restrictions on the manner in which those shares are voted and may of course, involve the mortgagee, in the case of a default, taking possession of the premises;
6. a mortgage or pledge by the corporation of its assets under a floating charge, or restrictions in a loan document that deal with the manner in which the tenant corporation deals with the lease and its business undertaking in the leased premises; and
7. indirect changes of control such as changes in a shareholder agreement, a loan agreement, a pledge of assets, a floating charge or, as in the case of individuals, a declaration of trust, or the entering into a partnership agreement in which the lease or the tenant's interest in the lease could be deemed to be partnership assets;

## **Partnerships**

Section 2 of the *Partnership Act of Ontario* defines a partnership as “the relation that subsists between persons carrying on a business in common with a view to profit, but the relation of the members of a company or association that is incorporated by or under the authority of any special or general *Act* enforced in Ontario or elsewhere or registered as a corporation under any such *Act*, is not a partnership within the meaning of this *Act*.”

The *Partnership Act* in Section 3 sets out a number of tests in determining whether a partnership exists. That *Act* also sets out detailed rules regarding the interests and duties of partners, their rights and obligations. The *Partnership Act* basically confirms the principles of partnership developed law at common law. The *Partnership Acts* of other jurisdictions are similar.

The most important consideration regarding the rights of partners and the control of a partnership is that the partners can in their partnership agreement vary those rights and obligations. Control might be exercised on the basis of unit of partnership interest, a percentage interest in the partnership assets, and by rules and requirements relating to the making of certain decisions

(major decisions) and the delegation of authority to committees within the partnership. Moreover, the partners' respective percentage interests in the partnership can vary depending on performance factors such as productivity, the introduction of business to the partnership by a partner and wide variety of other factors. A partnership interest might also be affected by the introduction of new partners or the removal of or retirement of partners.

The most important point to remember is that control of a partnership can only be properly understood by a careful examination of the partnership agreement. It is also important to note that a partnership can be made up of corporations, other partnerships and other types of entities. Partners do not have to be individuals. Accordingly, even where there is a controlling partner within a partnership, effective control can change when a change of control of the controlling partner takes place.

### **Limited Partnerships**

Subsection 21 of the *Limited Partnership Act of Ontario* provides that “a limited partnership shall consist of one or more persons who are general partners and one more person or more persons who are limited partners.”

“Persons” is defined to include an individual, a sole proprietorship, partnership, unincorporated association, unincorporated syndicate, unincorporated organization, trust, body corporate, and an actual person in his or her capacity as trustee, executor, administration or other legal representative.

(It is interesting to note that there is no definition of “person” in the *Partnerships Act*. However, generally speaking the same persons who can form a limited partnership could also form a general partnership based on common law.)

Section 9 of the *Limited Partnership Act* provides that a limited partner is not liable for the obligations for the limited partnership except in respect of the value of money and other property the limited partner contributes or agrees to contribute to the limited partnership, as stated in the record of the limited partners.

Limited partners are entitled to share in the profits of the partnership and to have access to the books and records of the partnership but, they are not permitted to and involve in the control of the business of the partnership. Pursuant to Section 13(1) if a limited partner takes part in the control of the business it loses its limitation of liability. Accordingly, for the purposes of determining control of a limited partnership, all of the same factors and concerns relating to a partnership pertain but only as respects to the general partner. Accordingly, the partnership agreement needs to be examined, because the general partners may themselves be general partners of each other pursuant to a separate partnership agreement and, control would need to be examined on at least two levels in that situation.

## **Trusts**

A trust is arrangement in which one entity, the trustee, holds an asset or assets for the benefit of another or others (the beneficiary or the beneficiaries).

The trustee might be a bare trustee in which case its only purpose and duty is to hold title to an asset subject to the direction and control of the beneficiaries of the trust or, it might be an operating trust in which the trustee or trustees are responsible for managing, operating and generally dealing with the assets for the benefit for the beneficiaries.

Particularly, in the case of a bare trustee arrangement, the identity, and nature of the beneficiaries would be of critical importance since the beneficiaries are effectively in control of the assets held by the trustee. Even when the trust is an operating trust, the nature of the beneficiaries may have a significant impact on the manner in which the assets are operated since it is their interests that are to be served by the trust relationship.

In determining who controls a trust and when control changes, it should be noted that a trustee can be an individual, a corporation, a partnership or virtually any other form of legal entity and, accordingly, depending on the nature of the trustee, control would need to be examined having regard to its particular nature and the documents governing its activities.

In addition, if the trustees of an asset are changed, a change of control can take place.

## **Joint Ventures**

For the purposes of this paper, we will treat a joint venture as a contractual arrangement between or among co-owners of an asset or group of assets who have entered into an agreement relating to a particular asset or group of assets but are not operating as a partnership. The co-owners' agreement would be the prime target for an analysis of control having regard to the definition of "major decisions", the role of a management committee, and, the various rights and restrictions among the co-owners pertaining to their co-ownership interests. The agreement can deal with buyouts, forced buyouts and various other arrangements among the co-owners that affect the ownership and use of the co-owned assets. In addition, since members of a joint venture can be virtually any type of entity, the nature of the co-owners must in each case be examined to determine where and to what extent changes affecting the control of a particular co-owner might affect the control of the joint venture under the co-ownership arrangement.

## **Associations Clubs and Other forms of Ownership**

A tenant may also take the form of a club, an association, an unincorporated group, or other informal organization. In each case, the constitution and organizing documents of the association entity, club or group would need to be examined to determine when a change of control occurs.

## **Permitted Changes of Control and Permitted Direct Transfers**

Once a determination is made concerning who actually has control of a tenant, there are two basic analyses that need to be made. The first involves determining when a change of control should or should not be permitted without the landlord's consent and, what conditions or restrictions should apply to the change of control. The second is an analysis of when a Direct Transfer might be acceptable having regard to factors related to control.

### **Permitted Changes of Control**

Generally, any change of control that has the result of weakening the financial strength of the tenant, or changing the basic character, business policies, practices and expertise of a commercial tenant will be a matter of concern to a landlord. In addition, keeping in mind the landlord's desire to ensure that the market rent associated with its lease accrues to the landlord's benefit, the landlord typically not wish for a tenant to be able to avoid situations which would require the landlord's consent in respect of a transfer by indirectly effecting a transfer by means of a change of control. This could be done, as explained above, in a variety of ways in connection with corporations, partnership, trusts, joint ventures, associations, clubs and other forms of ownership.

Following are comments concerning particular types of transactions that are frequently dealt with in the context of changes of control.

### **Public Corporations**

When a corporation's shares or voting securities are listed on a public stock exchange, it is not able, practically, to control share transfers or changes in control and accordingly, changes in control the corporation are usually not subject to the landlord's consent. The landlord will however often seek to impose a requirement that if there is a change of control of a public corporation the corporation must demonstrate to the landlord that the change will not have a materially adverse effect on its financial strength operating practices or policies of the tenant. As a practical matter such a requirement is often difficult to enforce and, the test of whether there is an adverse change is not an easy one to measure.

When a tenant is a subsidiary of a public corporation and the control of the public corporation is changed, the effective of control of the tenant also changes and, in that situation the requirement for the landlord's consent would typically be dealt with in the same way as a change of control of the tenant when the tenant is a public corporation.

### **The IPO**

Another common exception to the requirement for landlord's consent is the situation where a private company chooses to become a public company by making an initial public offering. This kind of change of control is often exempted on the basis that the transaction is regulated by governmental restrictions that protect investors and, would not normally result in a negative

impact on the tenant. Also, the going public of a private company would seldom if ever be done for the simple purpose of avoiding the requirement for the landlord's consent to a Direct Transfer in order to allow the tenant to capitalize on an increase in market value of its lease.

### **Corporate Arrangements**

Section 192 of the *Canada Business Corporations Act* (and similar sections in the corporate legislation of the Provinces) make provision for amalgamations, mergers and restructuring and, tenants will typically ask for those transactions to be exempted from changes of control in respect of which the landlord's consent is required. An amalgamation involves one or more corporations continuing as a single corporation with all of the assets and liabilities of the amalgamating corporations being combined into one corporation. The merger of corporations would typically involve acquiring or combining assets under some kind of an acquisition arrangement but with the merging corporations not combining into a single corporate entity. A restructuring might involve a rearrangement of shares or any combination of transactions contemplated by the statute. Generally, these kinds of transactions would not have the effect of adversely altering the financial strength, operating practices or policies of the tenant (so long as in the case of a merger, the company acquiring the assets is the tenant, or alternatively, the acquiring tenant assumes the tenant's obligations), nor would they be entered into for the purposes of avoiding the landlord's consent to a Direct Transfer. For that reason they are treated differently. Nevertheless, it would be prudent in each case to impose as a prerequisite some kind of assurance in favour of the landlord that the particular transaction would not have an adverse effect and that the tenant's obligations are assumed by or continued in the acquiring corporation. This would involve prior disclosure of the contents of the agreement and arrangements, and very careful analysis. However, generally, these kinds of transactions would be entered into by corporations with a wide spread collection of assets. Involving the landlord in a detailed analysis as a prerequisite to enabling the corporation to proceed would in many instances be resisted.

One type of transaction which is often referred to within the same category of transactions as amalgamations, mergers or restructurings, is a corporate reorganization. Care should be taken in connection with the use of "reorganization" in the context of an exempted corporate change of control. Section 191 of the *Canada Business Corporations Act* defines "reorganization" to mean a court order made under, (a) Section 241 (Note that Section 241 deals with oppression orders resulting from a complainant that feels that it is necessary to interfere with the actions of a corporation or any of its affiliates); (b) the *Bankruptcy and Insolvency Act* approving a proposal; or (c) any other Act of parliament that affects the rights among the corporations, its shareholders and creditors. The landlord should not exempt reorganizations and would generally, prefer to hold on to whatever rights it has at law to protect itself from such transactions.



## Permitted Direct Transfers

Following is a list of types of Direct Transfers that might be considered as acceptable without the need for a landlord's prior consent:

1. an assignment of the lease by a corporation that is a subsidiary of a corporation (a "Parent") to another subsidiary of that same Parent;
2. an assignment of a lease by a corporate tenant that is controlled by an individual, a partnership, or other entity or group to another corporation that is also controlled by that same individual, partnership, or other entity or group;
3. an assignment of a lease by a corporate tenant to its Parent or vice versa;
4. an assignment of lease by a corporate tenant to its controlling shareholder or vice versa; (the controlling shareholder might be an individual, a partnership, a trust or another entity), or vice versa;
5. an assignment of a lease by a tenant to a trust in which the tenant is the trustee, the controlling shareholder of a corporate trustee, or the controlling partner of a partnership that is the trustee;
6. an assignment of a lease by a tenant to a partnership in which the tenant is the controlling partner, or vice versa;
7. an assignment of a lease by an individual tenant to that individual's child, sibling, or spouse under an arrangement in which management and control of the lease or the business of the tenant rests with the assigning individual pursuant to a form of management agreement.

The number and types of transactions that might occur in connection with a Direct Transfer where control is not changed is only limited by the imaginations of those involved. It is not surprising that parties will try to find some way of categorizing in a limited way the types of transactions that might be acceptable in relation to control and direct transfers. Toward that end, it is not unusual for the parties to use terms such as "affiliates", "associates" or "related persons" and to define them by incorporating definitions from federal or provincial statutes that deal with corporations, income tax, or securities.

## **Affiliates, Associates and Related Persons**

It is critical for the parties to use the terms “affiliate”, “associate” or related person” carefully in the context of landlord consent requirements and changes of control issues. There is often a lack of precision in dealing with those terms which can result in unexpected and unwanted results.

In this regard, it is useful to examine the definitions of those terms under applicable legislation. Frequently, the *Canada Business Corporations Act* definition of affiliate or associate is used and, the definition of “related persons” under the *Income Tax Act* is sometimes referred to. The applicable definitions are included in the slides comprising the PowerPoint presentation attached to this paper as Exhibit 1.

It is readily apparent that the degree of connection, control and relationship among persons that can be “associates” or that might be related persons, is very wide. The definitions allow for a dizzying and confusing network and range of relationships be included.

In contrast, the definition of “affiliated bodies corporate” is much easier to deal with. The definition is as follows: “affiliated bodies corporate:

- (a) one body corporate is affiliated with another body corporate if one of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person; and
- (b) if two body corporate are affiliate with the same body corporate at the same time, they are deemed to be affiliated with each other.”

From a landlord’s perspective the use of “affiliated bodies corporate” is much less risky than the situation in which transactions involving associated or related persons are permitted. However, even when identifying transactions that are permitted on the basis that they involve an affiliate, should be done carefully having regard to the comments set out earlier in this paper, to the effect that the entity that is the “tenant” in a lease can change. If a lease is assigned, then the group of entities that are affiliates of the initial tenant might be entirely different from the group of entities that are affiliates of the transferee.

## **What if the Entities in Question are a Partnership, a Trust or a Joint Venture?**

Restricting Direct Transfers or changes of control to or among “affiliates” is not very useful in the context of partnerships, trusts or joint ventures since the concept of “affiliated corporate entity” is restricted to corporations. This leads us to consider whether the definitions of “associate” or “related persons” may be appropriate.

## **Associates**

The definition of Associates under the CBCA is set out in the PowerPoint presentation attached to this paper.

Subclause (a) deals with bodies corporate but subclauses (b), (c), (d), (e) and (f) deal with partners, trusts, spouses, children and relatives.

### **Related Persons**

Section 251 of the Income Tax defines “related persons” in subclause (2) (a) as “individuals connected by blood relationship, marriage or common-law partnership or adoption”.

In the context of partnerships, trusts and joint ventures, those definitions might be of some use as a reference. However, neither of them is restrictive enough or detailed enough to give a landlord the control it would prefer. It is easy to postulate a wide variety of situations where a transfer to a relative, a child, a partner or partners or to an individual connected by blood relationship or marriage might very well result in a significant change in the character of the tenant in possession of the premises or might result in a party with no real connection to the tenant obtaining possession of the premises or control of the tenant entity.

The recommended approach in considering what changes of control and what Direct Transfers should be permitted would be to create a “tailor made” specifically negotiated carefully defined list or category of persons or entities and to make provision for the landlord to have access to whatever documents the landlord considers reasonably necessary to examine in order to satisfy itself that the particular transaction in each case is a transaction that falls within the defined category or list.

### **What Information is Available?**

Considering the importance of obtaining information relating to the tenant and the proposed transferee having regard to issues related to control, it is important to note that public information in relation to private companies, trusts, partnerships and joint ventures, is very limited. Attached is Exhibit 2 of this paper is a list of the kinds of information that a typical “Cyberbahn” search might disclose in connection with a private corporation. Little information relevant to financial and operating concerns is obtainable.

Concerning partnerships, a copy of Declaration Form 3 of the *Limited Partnership Act* is attached as Exhibit 3 to this paper. That form indicates that in regard to the general partner in a limited partnership, very little information is required to be provided. It is interesting to note that the limited partners are required to be disclosed in a limited partnership arrangement as well as the amount invested or agreed to be invested by each limited partner.

Regarding partnerships, there is no provision under the statutes such as the *Partnerships Act of Ontario* requiring any registration. The only public registration that might apply would be the *Business Names Act* which requires that partnership names be registered and, where the partners carry on business under a name that is composed with the names of the partners, no registration at all is required.

## **Conclusion**

The information provided above and in the exhibits of this paper are intended as a resource to assist in the drafting of leases. The drafting of the lease transfer and change of control clauses will in each instance require thoughtful analysis of the needs of the landlord and tenant respectively, and careful tailoring of lease language that avoids shortcuts and the adoption of definitions from statutes or other sources that may be inadequate.