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## Not Every Transfer Triggers A Tenant's Right of First Refusal To Purchase

This is a tale of hard work rewarded in the face of a perilous right of first refusal to purchase.

Salvatore (Sam) Caruso, a 72 year-old semi-retiree working a few days a week, had amassed a nest egg for his family over his years in the hairdressing business. He owned a building on Jane Street, in Toronto, in which his salon was located. He owned another small commercial building on Lakeshore Road in Mississauga. These two buildings had been purchased as investments to see Caruso and his family through his retirement. Jose-Maria Tavares Enterprises Ltd. was Caruso's tenant at the Lakeshore property since 1985, operating a restaurant known as "The Great Canadian Pizza Company". Caruso had purchased the Lakeshore property in 1974.

The lease between Caruso and Tavares included a right of first refusal to purchase in favour of Tavares. The right of first refusal stated that it would be triggered if Caruso received a bona fide offer to purchase the property that Caruso was prepared to accept.

In the fall of 1999, Caruso decided to engage in some tax and estate planning. As a result, an estate tax freeze transaction caused both the Jane Street and the Lakeshore properties to be transferred to Desaro Holdings Inc., a company controlled by Caruso (who held the only voting shares). Caruso's wife and children held non-voting shares in Desaro.

The transaction was structured as a rollover, with the consideration for the transfer of the Lakeshore property to Desaro being, as set out in the land transfer tax affidavit, \$250,000.00. The consideration was not paid

in cash, but by preferred redeemable shares in Desaro. The transaction was structured to allow for the preference shares to be redeemed whenever Desaro had surplus cash flow to pay the taxes. The intention of the transaction was to reduce the amount of tax payable by Caruso's estate as a result of the deemed disposition of real estate upon his death.

Tavares claimed that Caruso's sale to Desaro triggered the right of first refusal in Tavares' lease. Tavares claimed that he did not learn of the transaction for over 2 years, by which time the property was worth over \$400,000. Tavares commenced an action claiming that Caruso should have sold to Tavares for \$250,000 and that Tavares was entitled to a conveyance from Desaro in exchange for that sum.

Caruso argued that there was never any bona fide offer to purchase the property. There was no offering of the property to the public or any solicitation of offers. It was a non-arms length transaction for estate planning purposes. As he testified in Court, the sale was "from Sam to Sam".

The Court noted that rights of first refusal to purchase are contractual rights. Once the right is triggered, it converts to an option to purchase which is an interest in land. The contractual right expires when the lease expires. An interest in land continues after lease expiry. At law, if the property is conveyed to a third party contrary to the option, the third party (in this case, Desaro) could be compelled to transfer the land to the party holding the option to purchase (in this case, Tavares). Tavares claimed that he had an option to purchase triggered by Caruso's transfer to Desaro. Tavares argued that Desaro's relationship to Caruso was of no consequence because the ROFR clause did not make this distinction. The ROFR only

called for a transfer to be bona fide, which the Caruso-Desaro transfer was since it was recognized by CCRA and the Ontario Ministry of Finance as a transfer with tax consequences. The trial judge disagreed with Tavares on two counts: firstly, it found that the interpretation sought by Tavares would generate an unreasonable outcome, allowing Tavares to enjoy the appreciation in the property at the expense of Caruso. The Court found that at the time the provision in the lease was negotiated, the intention of the parties was that the ROFR would only be triggered on a sale to a third party. Furthermore, the ROFR was not triggered because there was no offer to purchase the property. Thus, the ROFR was never converted to an option.

Desaro was allowed to keep the property. The case is “Jose Maria Tavares Enterprises Ltd. v. Salvatore Caruso and Desaro Holdings Inc.”, Ont. Sup. Ct. J. File No. 02-BN-10537 (unreported).

Although this story has a happy ending for the Caruso family, and one that most readers would be satisfied with as achieving a fair and proper resolution of the dispute, the fact is that it was never a slam-dunk that Caruso would win. There is plenty of case law that holds that a single property can be carved out of a transfer of multiple properties for purposes of satisfying a tenant’s right of first refusal, even if the purchase price is for the entire group of properties without any separate allocation.

There is also case law that comes to the opposite conclusion. There is also case law that a transfer to a related entity does not defeat a right of first refusal. Nor can the transferor give the property away to defeat the right of first refusal.

So what type of transfer or sale in fact triggers a right of first refusal to purchase? As lawyers are wont to say, “it depends”. What the clause itself says is very important. Often it calls for a “bona fide” offer to purchase. The phrase “bona fide” means “good faith”, which is usually defined as the absence of bad faith. An “offer” to purchase can take many forms. The offer need not come from a third party unless the clause so states or the intention of the parties is later determined to have been so limiting. If the clause does not address every issue, the courts will have to make a determination based on legal principles and the laws of interpretation.

Although leases infrequently contain rights of refusal to purchase, every time such a right is negotiated the parties might turn their minds to questions such as whether related party transfers trigger the right, whether the triggering offer must be in writing, whether a portfolio sale is caught by the right, and whether the transfer must be only for cash consideration to be subject to the right. It will certainly assist in the interpretation of such clauses if these issues have been addressed at the outset.

Daoust Vukovich LLP is delighted to announce that **Ron Haber** and **Dawn Michaeloff** have become partners of the firm. Ron was called to the Bar in 1984. His practice focuses on real estate development, construction, financing, acquisitions and sales. Dawn continues her commercial leasing practice, bringing 17 years of experience in the real estate market to Daoust Vukovich after previous stints at Cadillac Fairview and TD Investment Real Estate.



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