WHO’S THE BOSS?
CORPORATE TENANTS AND INDIRECT TRANSFERS

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Transfer provisions can be some of the most heavily negotiated provisions in a commercial lease. A landlord will typically want to retain as much control over the entity that is the tenant under its lease, including, in some instances, the ultimate underlying identity (i.e. parent entities, shareholders etc.) of such tenant. A landlord’s decision to lease space to a particular tenant is based on a variety of factors, such as financial capabilities, creditworthiness, the quality and type of operation of a tenant’s business, the tenant's management, style of business and other reputational factors. From a tenant’s perspective, business realities may change over time and a tenant will want to retain the maximum flexibility to control and revise its various corporate arrangements. For example, during the term of a lease, a tenant may wish to rearrange its organizational structure(s), enter into financing arrangements, raise capital, go public, or eventually even sell its business to a third party purchaser. The transfer provisions in a lease will dictate the balance between the extent of control that a tenant has over its business operations and the landlord's desire to maintain control over the quality, composition, and financial capability of a tenant.

Most commercial leases will contain a basic restriction on assignment or transfer without the landlord’s prior written consent since a covenant against assignment or subletting is not implied by law as a term of a lease. The limits on a tenant's right to assign its rights and obligations under a lease, in whole or in part, during the term of the lease must be explicit and a landlord must take care to prohibit all conduct that it wishes to control.¹ A covenant on the part of the tenant that it will not assign or sublet cannot be implied.² Further, the courts will construe the wording of the covenant not to assign or sublease without the consent of the landlord strictly against a landlord since such a covenant against assignment and subletting is a restraint on alienation.³ The basic restriction on assignment or transfer typically deals with a direct assignment of a lease. In this paper, we will focus our attention on “indirect transfers” whereby there is potentially a deemed assignment of the lease by operation of a change in control or ownership of a corporate tenant.

It is common to find restrictions on indirect transfers in commercial leases where the legal entity that is the tenant (other than in the case of an individual tenant) remains constant while the control of the tenant

¹ Loeb Inc v. Cooper (1991), 5 OR (3d) 259, 3 BLR (2d) 8 (CJ) [Loeb] at para. 80.
³ Dominion Stores Ltd v. Bramalea Ltd, 38 RPR 12, [1985] OJ No 1874 (Dist Ct) at para. 20.
is changed or the control of the underlying identity of the tenant is changed. Such indirect transfers may occur where the owner of a corporate tenant wishes to sell its business by a sale of shares in the tenant or alternatively merges or amalgamates with another corporate entity. While our discussion in this paper is limited to corporations, it is recommended that lease provisions which purport to limit the ability of a tenant to transfer or restructure its ownership be assessed and considered in the context of general partnerships, limited partnerships, joint ventures and trusts and other similar types of entities.

**Change of Control**

As discussed above, a landlord needs to explicitly prohibit or restrict the conduct that it wishes to control. In this regard, if a landlord requires that a change of control of a tenant is to be subject to the landlord’s consent, then the transfer provisions of a lease must be drafted in a manner so that a change of control is considered to be an assignment of a lease. In many standard landlord forms of lease (particularly in most sophisticated landlord standard forms of lease), changes in control of a corporate tenant are treated in the same manner as a direct transfer of a commercial lease and is often stated to be a deemed assignment of the lease. The rationale for such a prohibition is that without it, a transfer could be effected by simply transferring control of the tenant, thus circumventing the assignment restrictions contained in the lease. For example, the consent of the landlord would be required to assign the lease to a purchaser of the tenant’s assets under a typical provision restricting direct transfers of a lease, however, unless the lease expressly states that change of control requires landlord consent then a shareholder’s interest in the corporate tenant (i.e. the shareholdings) could be sold to a third party purchaser without the requirement to obtain the landlord’s consent and, as a result, the landlord would be contracted under the lease with a tenant who has an entirely different underlying identity.

While it is increasingly common to find change in control restrictions in commercial leases, the substance of such clauses vary significantly from lease to lease. Some clauses are brief and appear to limit changes of control to the control of the corporate tenant itself (i.e. a transfer of the shares in the capital of the corporate tenant) while other forms will go into much greater detail of what constitutes a change of control, including speaking to changes of control throughout different levels of a corporate tenant’s organizational structure, such as changes in control of a tenant’s parent company(ies) (otherwise referred to as an indirect change in control of the tenant), or contemplating a change of control that might result
from a tenant’s pledge of shares in a financing arrangement where a lender takes possession and control of the pledged shares upon enforcement.

When drafting lease assignment provisions, it would be prudent for both landlords and tenants to clearly define the terms “control” and “change of control” and “change in effective voting control”, as applicable. This will ensure that the correct determination is made in the future as to whether or not a proposed corporate reorganization or share transfer will be deemed an assignment under a lease requiring the landlord’s prior written consent and will help to avoid disputes over interpretation and intent.

It is not uncommon for a definition of control to be absent from a lease and, in such instances, the parties must consider the primary types control being (1) de jure control (i.e. legal control of a corporation) and (2) de facto control (factual control). De jure control is often based on the ability of a person(s) or other entity(ies) (i.e. a corporate shareholder) to elect a majority of the board of directors of a corporation, the distribution of voting shares in the capital of a corporation and any agreements that may restrict or limit the voting rights held by shareholders, such as a shareholders’ agreement. De facto control focuses on influence over a corporation rather than legal power and exists where the exercise of a person’s influence would result in control in fact of a corporation.

For example, "controlled" could mean a right to cast a majority of the votes which may be exercised in order to authorize any decision of such company or other entity, or alternatively the possession, directly or indirectly, of the power to direct and manage or cause the direction and management of the policies of a corporation. It is also common to see language in a change of control provision of a lease that sales, transfers or other dispositions aggregating a certain predefined percentage of the voting stock of a tenant (if a tenant is a non-public corporation) shall be deemed to be an assignment of this lease.

In many cases, leases will reference the term "effective control" of a tenant. A common interpretation of "effective control" is that it captures indirect changes of control of a tenant, such as a change in control of a direct or ultimate parent company of a corporate tenant, which would necessitate landlord consent. There could be many layers in a corporate tenant’s organizational structure. If a landlord is concerned about the continuity of the entity or individual that ultimately controls the tenant, the landlord should consider including express language that captures that a change in a control of a direct or ultimate parent entity constitutes a change of control of the tenant for the purposes of the lease.
Where a lease contains a restriction on effecting a change of control without the landlord’s consent, the lease will often contain language stating that the tenant must make available to the landlord all of its corporate books and records for landlord’s inspection at all reasonable times in order for the landlord to ascertain whether any change of control has occurred. Tenants and their counsel would be wise to reject such a clause or at the very least limit the extent to which a landlord is permitted inspect its corporate records or, in the alternative, agree to prepare and deliver to the landlord a statutory declaration from a senior officer of the tenant confirming to the landlord as to whether or not there has been a change of control.

**Amalgamations and Restructuring Transactions**

Corporate tenants may undertake certain transactions with third parties or related entities pursuant to which the corporate tenant will amalgamate or merge with such party(ies). These types of transactions may be effected for various reasons, including for tax planning purposes, corporate restructuring or as part of a step in an acquisition or divestiture. Landlords and tenants will want to carefully review the transfer provisions of a lease to identify whether an amalgamation or other similar restructuring transaction will breach the tenant’s assignment covenants or whether it will be permitted without the involvement of the landlord.

Canadian courts have generally recognized that the amalgamation of a tenant corporation does not constitute a transfer or assignment of a tenant’s lease absent express language to the contrary. 4 Where a lease does specifically prohibit an amalgamation, the landlord’s consent will be required. 5 The rationale behind these decisions are based on the interpretation of the various provincial and federal statutes as well as the seminal case that addresses the effects of amalgamation, R v. Black & Decker Manufacturing Co. Limited ("Black & Decker"). 6 In Black & Decker, the Supreme Court of Canada established the principle that an amalgamated corporation is a continuation of the pre-amalgamation corporations. The Supreme Court posited a theory that the end result of amalgamation is "to coalesce to create a homogeneous whole. The analogies of a river formed by the confluence of two streams, or the creation of a single rope through the intertwining of strands" 7 and further went on to state in analyzing the statute that "[t]he effect of the

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4 See Rossi v. McDonald’s Restaurants of Canada Ltd (1991), 1 BLR (2d) 175, 25 ACWS (3d) 639 (BCSC) [McDonald’s]; Loeb, supra note 1, Zurich Canadian Holdings Ltd v Questar Exploration Inc, 1999 ABCA 75, 26 RPR (3d) 282 [Zurich].
5 Loeb, supra note 1.
7 Ibid at para. 421.
statute, on a proper construction, is to have the amalgamating companies continue without subtraction in
the amalgamated company, with all their strengths and their weaknesses, their perfections and
imperfections, and their sins, if sinners they be. On the basis of the Supreme Court’s theory in Black &
Decker, the Courts have determined in subsequent decisions that the property and rights of each pre-
amalgamation corporation continue to be the property and rights of the amalgamated corporation. Both
federally and provincially, corporate statutes govern the manner in which two or more companies
amalgamate. Section 186 of the Canada Business Corporations Act provides that “the property of each
amalgamating corporation continues to be the property of the amalgamated corporation”. Similarly,
Section 179 of the Business Corporations Act (Ontario) provides that the “amalgamated corporation
possesses all the property, rights, privileges and franchises and is subject to all liabilities, including, civil,
criminal and quasi-criminal, and all contracts, disabilities and debts of each of the amalgamating
corporations”. The statutory provisions support the view held by the Supreme Court in Black & Decker.

An assignment involves an act by the transferor to convey the object of the assignment from one person to
another and involves a divestiture of the assignor of the right assigned. In the case of an amalgamation,
however, the amalgamated company possesses but does not actually acquire the property of the
amalgamated companies – there is no "divesture" of the assets by the pre-amalgamation companies. Put
simply, there is no transfer or assignment of assets upon the occurrence of an amalgamation.

There is a potentially open issue as to whether an amalgamation would be captured under an assignment
provision that prohibits assignment by way of "operation of law". Assignments by operation of law, such as
court-ordered property transfers, bankruptcy-related transfers, and transfers to or from an executor
or an administrator, are generally considered involuntary assignments. Whether amalgamations are
considered to be assignments by operation of law is a grey area. The decision of the Saskatchewan Court

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8 Ibid at para 422.
9 See for example, McDonald’s, supra note 3, Loeb, supra note 1 and Zurich, supra note 3.
10 Canada Business Corporations Act, RSC 1985, c C-44.
11 Ibid at s186(b).
12 Business Corporations Act, RSO 1990, c B.16 [OBCA]. Similar statutory language is found throughout the
Provinces, for example, in British Columbia, see s 282 of the Business Corporations Act, SBC 2002, c 57, and in
Alberta see s 186(b) of the Business Corporations Act, RSA 2002, c B-9.
13 OBCA, supra note 8 at s 179(b).
para. 43.
15 Jeffrey H Shore & Jonathan Freeman, “Reformation and Reorganization of the Tenant, Unique Issues in
Amalgamation, Reformation and Transfers” (Paper delivered at The Six Minute Commercial Leasing Lawyer – Law
Society of Upper Canada, 15 February 2006) [unpublished].
of Queen’s Bench in Crescent Leaseholds Ltd v. Gerhard Horn Investments Ltd (“Crescent”)\(^\text{16}\) is a frequently cited exception to the courts’ holdings discussed in the preceding paragraphs. In dismissing the theory asserted by the Supreme Court of Canada in Black & Decker and ignoring the principle of stare decisis, the Court in Crescent held that an amalgamation breached a restriction in a lease which prohibited an assignment by operation of law and held that the assets of the pre-amalgamated corporations are transferred to the amalgamated company\(^\text{17}\). Although this case has generally not been followed, in Loeb the Court is believed to have implied in obiter dicta that the amalgamations at issue in Loeb may have been caught if there was an express prohibition in the lease against an assignment by operation of law\(^\text{18}\).

As discussed above, a landlord that wishes to have a tenant seek the landlord’s consent to an amalgamation with another related entity within its organizational structure or an unrelated third party corporation must expressly provide for such a requirement in the assignment provisions of the lease. Further, based on the uncertainty surrounding whether or not an amalgamation would be caught under an assignment provision restricting an assignment by operation of law, it would be prudent from a landlord’s perspective to include additional language specifically restricting amalgamations and other restructuring transactions if that is the behavior that it wishes to control.

From the tenant’s perspective, a tenant may want to avoid including a provision in its lease which would require it to obtain the landlord’s consent where it is amalgamating or effecting a restructuring transaction with another corporate entity, whether or not related, to ensure that it has the requisite flexibility to undertake such arrangements. Tenants and their counsel should carefully consider how the transfer provisions of a lease are drafted to ascertain whether the transfer language specifically includes a prohibition against mergers, amalgamations or other restructuring transactions. It is also important for both parties to understand that, while a lease may not expressly require a landlord’s consent to an amalgamation, if the amalgamation results in a change of control of the tenant then such amalgamation may be caught by a change of control clause and the landlord's consent may be required.

**Exceptions and Permitted Changes of Control**

**Public Companies**

While changes in shareholdings of a corporate tenant may result in a change of control that requires

\(^{16}\) Crescent Leaseholds Ltd v. Gerhard Horn Investments Ltd (1982), 141 DLR (3d) 679, 19 Sask R 391 (QB).

\(^{17}\) Ibid at para. 28.

\(^{18}\) Loeb, supra note 1 at para. 82.
landlord consent, commercial leases often include exceptions in the case of a corporate tenant whose shares are listed on a recognized stock exchange. The rationale for this exemption is that a public company does not have the ability to control transfers of its shares. Public corporations should not agree to lease provisions that treat a transfer of shares or issuance of shares as an assignment of the lease without such an exception. Further, operating divisions owned by public companies may not be public themselves, so if there is a change of control of the public company parent, there could theoretically be a violation of the change of control provisions in the lease (depending on how control is defined in the lease, as discussed earlier). In this regard, a tenant may also want to expand any exemption for public corporations to include a change of control of a private corporation which is controlled by a public corporation whose shares are listed on a recognized stock exchange.

**Going Public Transactions**

Where a corporate tenant is a private company at the time that it enters into a lease but has aspirations of going public, whether by way of an initial public offering, a reverse takeover or otherwise, it would be wise for a tenant to specify that any such going public transaction is exempt from the change of control restrictions contained in the lease. Given that there are significant investor protections imposed on a company when it effects a going public transaction, it is unlikely that such a transaction would result in a tenant with weaker financial capabilities or adverse changes to the quality and composition of the tenant. From a tenant’s operational perspective; it would also be impractical to have to obtain landlord’s consent at the time that it wishes to go public. Further, upon going public, the same issues arise as discussed above for public companies as the shares are freely traded.

**Succession Planning**

In the context of a privately held small business there could be a sole individual owner/operator that controls the corporate tenant. Such small business owner tenants may have expectations of passing on the business to family members during their lifetime, to have such family members inherit the business or for the estate to be able to sell the business upon the death of the controlling shareholder. For a tenant that has a succession plan in place, it may request that it be permitted to undergo a change in control in accordance with such plan without the landlord’s consent if the shares are transferred (a) by reason of death or incapacity, or (b) to a spouse, parent, child or member of the transferring shareholder’s immediate family or to a trust established for the benefit of the transferring shareholder or any such spouse, parent, child or family member. If this exception is to apply, landlords and tenants should clearly define the meaning of "immediate family" and who specifically is captured by the definition.
Sale or Transfer of Shares amongst Existing Shareholders

If the shares of a corporate tenant are widely held, a landlord may be faced with a request that a tenant be permitted to effect a sale or transfer which results in a change of the effective control of such tenant among its shareholders existing as of the date the lease is executed. A landlord would likely agree to this request, subject to the landlord receiving certain assurances discussed below and that the landlord also receives notice of such change in control, including the names of the new shareholders and a breakdown of their shareholdings.

Transfers to a Third Party Purchaser

Tenants with significant bargaining strength are often able to negotiate a provision for a permitted sale to a single purchaser of all or a specified portion of such tenant’s business without the consent of the landlord. If the assignment provisions in the lease capture indirect assignments by way of change of control, the tenant should include language that the purchaser can purchase the tenant’s business either directly by way of an asset purchase (which would involve a direct assignment of the lease to the purchaser) or indirectly through a share purchase so as to ensure that there is no restriction on the manner in which the tenant ultimately decides to sell its business. The rationale behind a landlord agreeing to such a provision is that any single entity that is able to purchase a certain tenant’s business (particularly large national or multi-national tenants) must have the financial wherewithal to complete such a large transaction.

Non-consent mergers or amalgamations

In certain circumstances, landlords will agree to allow the tenant to assign the lease to a company formed as a result of a merger or amalgamation, or undergo a change of control of the tenant, where after such change of control, control vests in a company formed as a result of a merger or amalgamation, or to effect a merger or amalgamation in the context of a bona fide fiscal plan or corporate reorganization of the tenant, in either situation, without the consent of the landlord. In most of these cases, it is unlikely that there would be an adverse impact on the financial capability, quality and composition of the tenant. The landlord may, however, request that it receive some of the assurances discussed below.

Assurances

For non-consent assignments or exclusions to the change in control provisions or restrictions on amalgamation that were discussed above, many landlords may impose or request requirements that an
agreement to such permitted transfer or exemption will be provided so long as the landlord receives assurances that such a transaction will not have a negative impact on the tenant’s financial strength or the continuity of its management and business operations. Often, such exemptions and permitted transfers will include qualifying language providing the landlord with the right to receive evidence reasonably satisfactory to it that there continues to remain a continuity of business practices, policies and mode and style of operation of the tenant notwithstanding the transaction. The landlord may also require evidence that the financial covenants of the tenant contained in the lease are not diminished by the consummation of such transactions. A landlord’s position is that it is leasing the premises to the tenant on the basis of the financial covenant, skill, management, reputation and/or business acumen of that particular owner/controlling shareholder and having an unknown shareholder/purchaser take-over or permit, for example, a scenario, where a corporate tenant’s financial strength is diminished following the transaction, is not something that it is willing to do without having an opportunity to consent to such transaction.

These sorts of assurances and guarantees may not be practical in every situation. For example, assurances relating to a continuity of business practices, policies and mode and style of operation would be impossible for any public company to ensure given the lack of control over a public company's share transfers and would likely be difficult for a landlord to enforce. In the context of private companies where succession planning is being contemplated or where transfer of control amongst shareholders is likely, there is a rising reluctance to provide assurances on continuity of existing management and operations given generational shifts or styles of management amongst the various stakeholders as control of a tenant shifts. Tenants should strongly consider these assurances and their potential impact or restrictions on the future of the tenant.

If a landlord does agree to any of the exceptions that were discussed above in this paper (or other similar exceptions) a landlord would likely require prior notice of the transaction together with some of the items indicated in the documentation section discussed below.

Documentation

In instances where either a landlord’s consent is required to a transfer, change of control, merger or amalgamation, or where the landlord does not require consent but does require that the tenant provide assurances, a landlord may require one or more of the following, as the context requires:
(i) an executed copy of the transfer documentation (such as a copy of the share purchase agreement, amalgamation agreement or arrangement agreement);

(ii) confirmation in writing of the tenant’s ownership structure both immediately before and after the transaction (which may include production of a shareholders register or other ownership register);

(iii) copies of any constating documents of the tenant and/or the underlying controlling entities;

(iv) audited financial statements of the tenant and/or the underlying controlling entities for the past two to three years;

(v) a written statement from the potential new underlying owner describing its plans for running the tenant’s business following completion of the transactions, including staffing plans and management positions and which employees are being retained. This information will provide the landlord with some colour and a glimpse into whether a smooth transition is reasonably likely and whether the business will be operated in a similar manner for the foreseeable future as previously conducted by the tenant during the term of the lease;

(vi) in the case of a change of control due to a third party purchaser of all the tenant’s shares, proof that the "transfer" or change of control in such an instance forms part of a business transaction whereby the buyer is acquiring as a going concern all or the specified portion of such tenant’s business. This proof can be in the form of a statutory declaration or an opinion from corporate counsel for the tenant; and/or

(vii) a written covenant in favour of the landlord pursuant to which the tenant and the new underlying owner agree to perform and observe all of the covenants of the original tenant under the lease.

A tenant’s response to a landlord on whether it will be able to reasonably provide the foregoing documents and substantiating evidence will depend on various factors, including confidentiality requirements, availability of audited financials (not every private company will have audited financial statements, newly formed companies will likely not have financial statements and public companies
should generally avoid disclosing financial information not generally available to the public) and the specific obligations that are set out in the lease itself.

**Conclusion**

The above is a summary of some considerations to keep in mind when drafting and reviewing transfer provisions as they relate to "indirect transfers" of corporate tenants and is not intended to be exhaustive. Transfer and change of control provisions should be carefully crafted in light of the requirements of both the landlord and the tenant. A prudent tenant should carefully review the transfer provisions and definitions, including "control" and "change of control" and "change in effective voting control", as applicable, in a lease to understand how these provisions will restrict its ability to operate or sell its business or for underlying owners to potentially deal with their estates. The consequences of vague or incomplete lease assignment provisions as they relate to "indirect transfers" could prove not only problematic, but in certain circumstances, a commercial and legal disaster for both landlords and tenants.