REFORMATION AND REORGANIZATION OF THE TENANT

UNIQUE ISSUES IN AMALGAMATION, REFORMATION AND TRANSFERS

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Introduction

Complex tax and securities driven reorganizations and restructurings are routinely being interposed on existing landlord and tenant relationships. Often, landlords find that their "standard" corporate tenants are being supplanted by REITs, income funds, limited partnerships and other multi-layered business structures.

This paper seeks to addresses two distinct issues related to the reformation and reorganization of tenants in today's leasing environment. The first issue is whether a tenant's amalgamation can violate a covenant not to assign the lease without the landlord's consent. The second issue is the threshold question, "who is the tenant?" when faced with these non-corporate tenants and multi-layered structures.

A. Landlord Consents to Amalgamation

Corporate tenants routinely reorganize their affairs through the process of amalgamation. What are the consequences of a corporate tenant's amalgamation *vis-à-vis* its leases? Does an amalgamation constitute an assignment for purposes of assignment restrictions in a lease?

1. Statutory Framework

In Canada, corporate statutes govern the manner in which two or more companies amalgamate. The effect of an amalgamation depends solely on the language used in each

* The authors gratefully acknowledge the input provided by their colleagues at Goodmans LLP and the research assistance of Marisa Wyse, student-at-law.

jurisdiction's statute. Pursuant to the *Canadian Business Corporations Act* ("*CBCA*"),[1] "two or more corporations, including holding and subsidiary corporations, may amalgamate and *continue* as one corporation".[2] After the amalgamation is complete, "the property of each amalgamating corporation *continues* to be the property of the amalgamated corporation".[3] Similar provisions can be found in Ontario's *Business Corporations Act*.[4]

2. The Supreme Court of Canada Weighs In

In *R. v. Black & Decker Manufacturing Co. Limited* ("*Black & Decker*"),[5] the leading case on the effects of an amalgamation (albeit in a quasi-criminal setting), the Supreme Court of Canada firmly established the principle that the amalgamated corporation is a continuation of the pre-amalgamating corporations. The Court made it abundantly clear that, under an amalgamation, "no 'new' company is created and no 'old' company is extinguished".[6] The Court carefully examined the language used in the *Canada Corporations Act*, the predecessor to the CBCA, and concluded that the controlling word in the provision governing amalgamations was "continue" which means "to remain in existence or in its present condition"[7] and that an amalgamation results when two or more corporate entities "coalesce to create a homogeneous whole".[8] This point was furthered by the analogy that an amalgamation is like "a river formed

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1 R.S.C. 1985, c. C-44.

2 *Ibid* at s. 181 (emphasis added).

3 *Ibid* at s. 186(b) (emphasis added).

4 R.S.O. 1990, c. B.16. Note that this paper only examines amalgamation in the context of CBCA model provisions and does not consider the effect of amalgamation under other types of corporate statutes.

5 [1975] 1 S.C.R. 411.

6 *Ibid* at 417.

7 *Ibid.*

8 *Ibid* at 421.

by the confluence of two streams, or the creation of a single rope through the intertwining of strands".[9]

With respect to property rights, the Court also noted that the amalgamated company "possesses" all of the property and rights of the amalgamating companies and commented as follows:

> If corporate birth or death were envisaged, one would have expected to find, in the statute, some provision for transfer or conveyance or transmission of assets and not simply the word "possesses", a word which re-enforces the concept of continuance; … .[10]

Accordingly, there is no assignment or transfer of assets when a company amalgamates.

On the same day that the *Black & Decker* decision was released, the Supreme Court of Canada also released its decision in *Witco Chemical Co., Canada v. Oakville (Town)* ("*Witco*"),[11] which unanimously affirmed *Black & Decker* and applied it in the context of an application to amend a statement of claim issued against a company that had been amalgamated.

3. The Decision in *Crescent Leaseholds*

In *Crescent Leaseholds Ltd. v. Gerhard Horn Investments Ltd*. ("*Crescent Leaseholds*"),[12] Mr. Justice Wright held that an amalgamation breached a restriction in a lease on assignment by operation of law. In so doing, he dismissed the "confluence of streams" and "intertwining strands" theory asserted in *Black & Decker* in favour of his own theory that under a corporate amalgamation, the property and assets of the amalgamating corporation are transferred to a new amalgamated corporation. Ignoring the principle of stare *decisis* and relying instead on

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9 *Ibid*.

10 *Ibid* at 417. The subsequent enactment of the CBCA strengthens this view; Section 186(b) of the CBCA states that the property of each amalgamating corporation "continues to be the property of the amalgamating corporation".

11 [1975] 1 S.C.R. 273.

12 (1982), 141 D.L.R. (3d) 679 (Sask. Q.B.).

the 1967 writings of a law professor, Mr. Justice Wright advanced his own theory stating that "it does not follow … that the property interest of amalgamating companies remains in the hands of each of the persons coming together in the amalgamated company".[13] In his opinion, "[t]o argue that the amalgamating companies continue to exist, although they no longer had any status or identity at law…smacks, with respect, of sophistry".[14]

It is important to note that, in *Crescent Leaseholds*, unlike the subsequently reported cases noted below, the assignment clause in the lease, in addition to the standard prohibition on assignments, included an express prohibition against *assignments by operation of law*. As a result, Mr. Justice Wright concluded that "where a prohibition against an assignment by operation of law is incorporated in a restrictive covenant the debate about the effect of amalgamation is no longer relevant".[15]

4. Post-*Crescent Leaseholds*

Crescent Leaseholds has routinely not been followed in subsequent decisions.[16] In the leasing context, the following decisions are notable:

(a) In *Rossi v. McDonald's Restaurants of Canada Ltd.*,[17] the Court followed the *Black & Decker* and *Witco* decisions and held that an amalgamation does not constitute an assignment. In reaching this decision, the Court expressly declined to follow *Crescent Leaseholds* and stated that an assignment requires a "complete

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13 *Ibid* at 691.

14 *Ibid*.

15 *Ibid* at 692.

16 Outside the leasing context, see *Heidelberg Canada Graphic Equipment Ltd. v. Arthur Anderson Inc.* (1992), 7 B.L.R. (2d) (Ont. Ct. (Gen. Div.)), *Re Manco Home Systems Ltd.* (1989), 72 C.B.R. (N.S.) 130 (B.C.S.C.), aff'd (1990), 78 C.B. R. (N.S.) 109 (B.C.C.A) and *Sign-O-Lite Signs Ltd. v. Carruthers,* [2000] B.C.J. No. 90 (B.C.S.C.).

17 (1992), 1 B.L.R. (2d) 175 (B.C.S.C.).

divestiture of the property or rights" being assigned.[18] Based on this proposition, the Court concluded that if an amalgamated corporation continues to possess all the property and rights it had before the amalgamation, there is no assignment.

(b) In *Loeb Inc. v. Cooper* ("*Loeb*"), [19] the Court also applied *Black & Decker* and expressly declined to follow *Crescent Leaseholds*, holding that the amalgamations in question did not result in the assignment of the lease and thereby did not violate the prohibition on assignment contained in the lease. However, the Court in *Loeb* went on to suggest in *obiter dicta* that the amalgamations might have been caught by an express prohibition against an assignment by operation of law had there been one in the lease. It has been put forward by some that, notwithstanding the steady stream of jurisprudence to the contrary, these comments in *obiter* effectively leave the door open to a *Crescent Leaseholds* argument *vis-à-vis* a tenant that has amalgamated without the landlord's consent in the face of an express restriction on assignments by operation of law.[20]

(c) More recently, in *Zurich Canadian Holdings Ltd. v. Questar Exploration Inc.* [21] the Alberta Court of Queen's Bench followed the Court's decision in *Loeb* and held that an amalgamation is not an assignment or transfer. *Crescent Leaseholds* was not cited by the Court in its decision.

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18 *Ibid* at 183.

19 (1991), 5 O.R. (3d) 259 (Gen. Div.).

20 Jeffrey W. Lem, "The Confluence of Streams, the Intertwining of Rope, and Other Sophistry: Amalgamations as an Assignment of the Lease," in *Assignment, Subletting and Change of Control in a Commercial Lease*, ed. Harvey M. Haber (Aurora: Canada Law Books Inc., 2002) at 87.

21 (1999), 19 R.P.R. (3d) 261 (Alta. Q.B.), aff'd on other grounds (1999), 171 D.L.R. (4th) 457 (Alta. C.A.).

5. Conclusions

In light of the case law, the following generalizations can be made with respect to amalgamations by tenants in the leasing context:

(a) where a lease expressly prohibits the tenant from amalgamating, the landlord's consent is required;[22]

(b) where the lease merely provides that it is not to be assigned without the consent of the landlord, there will be no breach of the assignment prohibition. The amalgamating companies continue their existence in the amalgamated company and, as an amalgamation involves no transfer or assignment, the amalgamated company possesses (but does not acquire) the property of the amalgamated companies;

(c) the courts will not expand the scope of a restrictive covenant. A simple prohibition on assignment will not be expanded to include a prohibition on amalgamation or a prohibition on assignments by operation of law; and

(d) logically, an amalgamation should not constitute a breach of a prohibition on assignments by operation of law. However, it remains possible that a landlord may attempt to make this argument on the basis of the *obiter dicta* in *Loeb* supporting *Crescent Leaseholds*.

Accordingly, landlords wishing to preclude amalgamations by their tenants should do so expressly in their leases. Conversely, tenants desiring flexibility should expressly include amalgamations in their lists of permitted transfers.

B. Lease Transfers to Trusts, Partnerships, Limited Partnerships and Nominees

[22] *Prime Restaurants of Canada Inc. v. Greey Realty Holdings Inc.*, [2003] O.J. No. 295 (S.C.J.).

Landlords should know with whom they are forming their relationships. This is true when negotiating an offer to lease or a lease and remains true when considering a request by a tenant for consent to transfer the lease, either to a related party or to a third party. Conversely, tenants and their assignees will want to ensure that the correct party is taking on the obligations associated with the lease.

Aside from statutory entities,[23] one may only contract with a natural person or a corporation (with or without share capital), the only other entity readily recognized in law as a distinct person.[24] We are all reasonably comfortable with what a corporation is and how it can contract. However, we are encountering other legal arrangements with greater frequency when doing business and it is worth re-visiting how we contract with them.

1. General Partnerships

A general partnership is the relationship that exists between persons, be they natural persons or otherwise, carrying on business with a view to a profit.[25] It is not a distinct legal entity separate from its members. Accordingly, aside from the right to commence proceedings or have proceedings commenced against it in the name of the partnership,[26] it is improper to use the partnership's name in a manner that suggests that it has its own identity or is capable of signing a contract.

With respect to partnership property, Justice Ground had the following to say in respect of limited partnerships but which is equally applicable to general partnerships:

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[23] Issues related to contracting with governments, including municipal and Crown corporations and agencies, utilities, charities, religious organizations, unions and the like, are beyond the scope of this paper.

[24] Tax law considerations aside.

[25] *Partnerships Act*, R.S.O. 1990, c. P.5, s. 2. Provided that if persons are carrying on such a business as a corporation or under any other legislation, that relationship is not a partnership.

[26] Ontario, Rules of Civil Procedure, r. 8.

> The concept of partnership property is also recognized in law but this does not mean that it is property owned by the partnership but rather property in which all of the partners have undivided interests. … None of these factors, in my view, constitutes a partnership a legal entity or person having a separate existence recognized in law and accordingly being capable of holding title to property … .[27]

Accordingly, when transferring a lease to a general partnership, the conveyance is made to each of the partners as co-owners and the leasehold interest is held by the partners as tenants-in-common in proportion to their percentage interests in the partnership.[28] Where there are more than a handful of partners, the partnership may wish to have the conveyance made to a nominee.[29]

By virtue of the provisions of the *Partnerships Act*, every partner is an agent of the firm and of the other partners for the purpose of the business of the partnership. A partner's usual acts for the business of the partnership bind the firm and the other partners, unless that partner has no authority and the third party knows this or does not know of the partnership.[30] However, when it comes to the execution of documents that are signed under seal, such as conveyances of property, one must keep in mind the following pronouncement:

> The cases for over a century establish the rule of law firmly that where partners contract under seal they are bound by the form of the instrument, and where parties so signing are merely acting as agents and are so described, only the parties signing can be bound. A principal or partner cannot be bound unless he has given authority for his signature under seal, and is designated as a party to the deed.[31]

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27 *Kucor Construction & Developments & Associates v. Canada Life Assurance Co.* (1997) 32 O.R. (3d) 548 (Gen. Div.) at 554-555 [hereinafter *Kucor (Trial)*], aff'd (1998), 41 O.R. (3d) 577 (C.A.) [hereinafter *Kucor (CA)*].

28 Wilfred M. Estey, "*Problem Areas in Giving Opinions*" (Paper presented to Insight Legal Opinions Conference, June 1998) at 17-18.

29 In this regard, the comments made under the heading "Nominees" are applicable.

30 *Partnerships Act*, *supra* note 25, s. 6.

31 *Porter v. Pelton* (1903), 33 S.C.R. 449 at 455.

As noted in the discussion under the heading "Nominees" below, leases fall into this same category of contracts under seal or special contracts and it would seem to follow that a transfer of the tenant's interest in the lease would also fall into this category of contract. To forestall future disputes as to whether one partner had the authority to bind the balance of the partners, a prudent landlord should have all the partners sign the offer to lease, lease or assumption agreement and make them jointly and severally liable for the obligations of the tenant.

2. Limited Partnerships

The use of limited partnerships abounds as it allows passive investors to limit their liability to their capital contribution while permitting the flow-through of losses and profits which may be used by the individual partners to off-set profits and losses from other ventures.

Like a general partnership, a limited partnership is also not a legal entity.[32] In Ontario, a limited partnership is a creature of statute that is formed when a declaration signed by all of the general partners is filed.[33]

In a limited partnership, the general partner is liable for all of the obligations of the partnership obligations and the limited partners are only liable to the extent of their contributions to the limited partnership. Unless a limited partner remains passive and avoids involvement in the management and control of the business, the limited partner can lose its limited liability.

It is through the general partner of the limited partnership that a limited partnership acquires and conveys title to real property, including leasehold estates. The transferee should not be the limited partnership or the individual limited partners; legal title to real property acquired by a limited partnership, including leases and transfers of leases, is held by the general partners

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[32] See for instance the discussion of Borins J.A. in Kucor (CA), *supra* note 27, at 587-588.

[33] *Limited Partnerships Act*, R.S.O. 1990, c. L.16, s. 3.

and should be recorded in the name of the general partners, each in its capacity as a general partner of the limited partnership.[34]

3. Nominees

Often, the transferee will structure its affairs such that title to the real property, be it freehold or leasehold, is held by a nominee or bare trustee for the transferee. Typically, the transferee adopts this arrangement for one or more of the following reasons:

(a) convenience – where the transferee is a joint venture comprised of a number of entities or, perhaps a "true" trust with natural persons acting as the trustees, a corporate nominee or bare trustee can be convenient;

(b) confidentiality – where there is a public record of the ownership, this arrangement may have some appeal to "shy" beneficiaries;

(c) conveyancing – dealings with land may be facilitated when a corporate entity appears on registered title and, at least in Ontario, use of corporate nominees may make it possible to achieve certain land transfer tax deferrals; and

(c) limiting liability – so long as the relationship remains unknown to third parties, the nominee can serve to insulate the beneficiary.[35]

A nominee or bare trust arrangement describes the relationship where a nominee or bare trustee holds legal title to property but acts at the direction and under the control of the beneficiaries. This relationship is usually evidenced in a nominee agreement or a declaration of trust whereby, among other things, the nominee or bare trustee agrees to hold the property as bare trustee for the beneficial owner and the beneficial owner reserves the right to control the property. The nominee or bare trust arrangement is not to be confused with the "trust"

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[34] *Kucor (Trial)* and *Kucor (CA)*, *supra* note 27.

[35] However, as described in this paper, subject to the sealed contract rule, an undisclosed beneficiary is liable for the actions of its duly authorized nominee under principal/agent law.

relationship described later in this paper where the *cestui que trust* does not have dominion over the trust property.

Where a beneficiary has constituted another person as the beneficiary's nominee or bare trustee, it has also constituted that person as its agent and it is the agency relationship that is relevant for the purpose of contractual liability. Therefore, the bare trustee, as agent, subjects its beneficiaries, as principals, to personal liability for contracts the bare trustee makes on their behalf.[36] Accordingly, courts have held that the beneficiaries of bare trusts are liable based on the rule that an undisclosed principal is liable for contracts made by its duly authorized agent.[37]

When presented with a request for consent to a transfer to another entity, the landlord should take steps to determine if the transferee is merely a nominee or a bare trustee for another entity. This may not be obvious. Accordingly, the landlord should ask the question and the assignment and assumption agreement might contain appropriate representations one-way or the other. If the nominee or bare trustee is known to the landlord, the landlord should ensure that there is a direction from the beneficial owner authorizing and directing the nominee to execute and deliver the assignment and assumption agreement as nominee and bare trustee for the beneficiary and the beneficiary should confirm to the landlord that the beneficiary is liable for the tenant's obligations under the assumed lease.

If the relationship is not known to the landlord, recourse to the beneficiary could be thwarted if the assumption documentation between the landlord and the transferee contains an express term which limits liability to the parties named in the contract.[38]

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[36] *Trident Holdings Limited v. Danand Investments Ltd.* (1988), 64 O.R. (2d) 65 (C.A.) at 73-75; *Edelstein Construction Limited v. The Fire Pit Inc.* (1996), 30 O.R. (3d) 383 at 389 (C.A.), leave to appeal to S.C.C. denied [1996] S.C.C.A. No. 525.

[37] *642947 Ontario Limited v. Fleischer* (2001), 56 O.R. (3d) 417 (C.A.) [hereinafter *Burnac*]. See also T.B. Rotenberg, "*642947 Ontario Limited v. Fleischer: Nightmare on Yonge Street*" (2002), 47 R.P.R. (3d) 214.

[38] *Burnac*, *supra* note 37 at para. 34.

Additionally, the sealed contract rule provides that when a contract is deliberately made under seal, only the parties to the contract may sue or be sued on it and, accordingly, an undisclosed principal is not liable on a sealed contract. In Ontario, under Section 13(1) of the *Land Registration Reform Act*, R.S.O. 1990, c.L4, "a transfer or other document transferring an interest in land" is said to have the same effect for all purposes as if executed under seal. While there are no reported decisions on the subject, it has been suggested that this provision extends to leases.[39] Where this provision applies, it is irrelevant whether or not there was an intention to create a sealed instrument. Accordingly, undisclosed principals often rely on this provision to avoid liability and courts may struggle to find reasons to avoid applying the rule.[40]

5. Trusts

A trust is not a separate legal entity. It is a relationship or obligation that exists in equity when a trustee is obligated to hold property for another.[41] As noted above, this relationship will go beyond that of a nominee or bare trust when it is structured such that the trustee, and not the beneficiary, has the power and duty to deal with the trust property.

Trusts are generally established by a declaration of trust whereby a settlor agrees to transfer certain property to the trustee and the trustee agrees to hold the property in accordance with the declaration of trust. There may be one or more trustees and a trustee may be a person or

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39 See B. Bucknall, "*Conventional and Unconventional Parties: How Documents are Engrossed and Executed*" (Paper Presented to Real Property Law: Conquering the Complexities, 2002 Law Society of Upper Canada Special Lectures, 2002) at 2-4. It is submitted that the sealed contract rule might also be applied to an assignment of leases. However, *vis-à-vis* the assignee's liability to the landlord, one could see how, in the case of an assignee taking a lease as nominee for another, it might be argued by the beneficiary that the "transfer" was between the assignor and assignee and any assumption covenants are not to be treated as sealed contracts as they fall outside the ambit of Section 13(1) of Act.

40 See *Friedmann Equity Developments Inc. v. Final Note Ltd.*, [2000] 1 S.C.R. 842 and *Burnac*, *supra* note 37, for examples. In the latter case, the court rejected the argument that a purchaser's equitable lien for a deposit under an agreement of purchase and sale constituted a "charge" and was, by application of Section 13(1) of the Act, automatically subject to the sealed contract rule.

41 Donovan W.M. Waters, Mark R. Gillen & Lionel D. Smith, eds., *Waters' Law Trusts in Canada*, 3rd ed. (Toronto Carswell, 2005) at 3 and 9.

a corporation. The trustee is the legal person vested with ownership of the trust's assets and has the power and duty to deal with the trust property in accordance with the terms of the declaration of trust. Accordingly, in the context of a trust structure, it is the trustee that is the proper transferee when a lease is assigned.

Historically, the most common type of trust was the estate planning trust (which lies outside the ambit of this paper). However, business trusts, such as real estate investment trusts (REITs), mutual funds and pension trusts, are becoming increasingly common. Like estate planning trusts, business trusts are created by the settlement of the trust and a declaration of trust. However, unlike traditional trusts, investors in business trusts subscribe for units representing a beneficial interest in the trust's assets. While the use of limited partnerships to hold the operating assets beneath the public business trust vehicle is typical, some business trusts with natural persons serving as trustees use a sub-trust structure whereby the business trust itself is the beneficiary of a sub-trust with a corporate trustee; it is the corporate trustee of the sub-trust that will hold the income producing assets of the business.[42] In this way, the trustees of the business trust hope to limit their liability. Furthermore, the declaration of trust for a business trust will usually specify the manner in which contracts are to be authorized and executed and, to facilitate matters, may specify that certain authorizations are to be made by committees, managers or administrators on behalf of the trustees or that the trustees may delegate such power, including the power to execute and deliver contracts. Accordingly, when contracting with a business trust, landlords should ensure that the contract has been properly authorized and executed by the appropriate persons, be they the trustees themselves or others properly authorized to do so on behalf of the trustees.

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[42] Frequently, one sees a combination of trusts, limited partnerships and corporations used in connection with a business trust.

Moreover, when dealing with a business trust, the trustees will typically insist upon protecting both trustees and unitholders from liability under the contract by limiting the other party's recourse to the trust's property. In the REIT context, these clauses typically take the following form:

> The parties hereto acknowledge and agree that the obligations of the Trust hereunder are not personally binding upon any trustee of the Trust, any registered or beneficial holder of units in the Trust (a "Unitholder") or any annuitant under a plan of which a Unitholder acts as trustee or carrier, and that resort shall not be had to, nor shall recourse or satisfaction be sought from any of the foregoing or the private property of any of the foregoing, but the property only of the Trust shall be bound by such obligation. Any obligation of the Trust set out in this Agreement shall, to the extent necessary to give effect to such obligation, be deemed to constitute, subject to the provision of the previous sentence, an obligation of the trustees of the Trust in their capacity as trustees of the Trust only.

A number of provinces have introduced legislation to limit the liability of unitholders of publicly traded business trusts. In Ontario, the *Trust Beneficiaries' Liability Act, 2004*, S.O. 2004, c.29, Sched. A, which received Royal Asset just over a year ago, provides that:

> The beneficiaries of a trust are not, as beneficiaries, liable for any act, default, obligation or liability of the trust or any of its trustees if, when the act or default occurs or the obligation or liability arises,
>
> (a) the trust is a reporting issuer under the *Securities Act*; and
> (b) the trust is governed by the laws of Ontario.

The Act applies to all activities or obligations of a trust or its trustees that occur or arise after December 16, 2004. Effectively, this limits the exposure of unitholders to claims against trusts to the amount of their investment thereby making an investment in a public business trust similar to an investment any other public corporation, tax considerations aside.

January, 2006